



The Institute for Urban Economics

Analytical overview

«PRACTICE OF REFORMS IN THE HOUSING AND COMMUNAL SERVICE SECTOR»

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Authors' collective

The overview was prepared under the leadership of Sergei Sivaev by the experts of Municipal Economy Division, The Institute for Urban Economics: Andrianov Valentin, Askerov Emin, Gordeev Dmitriy, Zaitsev Roman, Kolesnikov Igor, Lykova Tatiana, Petrova Ekaterina, Prokofiev Vladilen, Rodionov Alexey, Rumiantseva Marina, Khomchenko Dmitriy, Shapiro Marina. Invaluable assistance in the analysis of reform progress was rendered by Raymond Struyk, senior fellow, Urban Institute (USA).

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INTRODUCTION

The present report is devoted to the analysis of reform progress in the housing and communal service sector, one of the most socially important sectors of the economy. The sector's problems have attracted much political attention in the recent years. To date, however, no significant positive changes have occurred. Moreover, there is multiple evidence of the deterioration in both the technical and financial situations of the sector. The housing and communal service sector plays the role of the last bastion of (communism) socialism, characterized by inflated and thus unfulfilled social mandates of the state, absence of real economic relations, and low quality of services produced. The deep depreciation of fixed assets, grave financial state of the sector enterprises, and social demagoguery in place of clear and understandable rules of the game make the sector unattractive for private businesses.

It is quite evident that the complexity and systemic nature of the sector's problems call for responsible political and economic decisions at the highest level of government.

However, while the housing and communal service sector is one of the biggest sectors of the national economy, its enterprises are scattered over the entire territory of Russia and fall under the jurisdiction of local governments. Attempts to implement sector reforms from the center alone look like trying to boil the ocean. No real changes can be achieved until a system of positive and negative motivation for all stakeholders, first of all local governments, is in place. In order to check once again the correctness of the strategic goals, characterized by the successes and failures in the selection of tactical reform steps, it is necessary to present the overall experience accumulated in the ten years of transformations in the housing and communal service sector, review the results achieved, and distinguish with maximum clarity the negative and positive experience acquired.

This report presents the results of an analytical survey of the experience of housing and communal service sector reforms in the past ten years, contrasting this experience with the declared reform goals and objectives, comparing the progress of reforms in different municipalities of Russia, identifying reasons for their successes and failures, and developing proposals for improving the efficiency of reform measures at the state and municipal levels on the basis of these analytical conclusions.

Of special note is that the research was intended to initiate a professional discussion of the results and of ways to further reforms in this sector of Russia's economy that is of vital importance to every citizen, rather than to provide recipes based on the analysis of the current practices.

The research was conducted with the use of statistical and expert data on the state of the housing and communal service sector in over 30 big and small municipalities. The authors are sincerely grateful to all leaders and specialists of various housing agencies in different parts of the country for their assistance in this work.

1. The Goals and Objectives of the Housing and Communal Service Reform

In the period preceding the reforms the housing and communal service sector was characterized by rigid state regulation of all housing relations and the predominance of state ownership.

The distinctive features of this system are:

- centralized allocation of all resources, including allocation of newly constructed housing among citizens depending on the need and waiting lists for improving the housing conditions; an almost complete unavailability of the credit mechanisms of finance;
- a state monopoly in housing maintenance and utility services, with the loss-bearing activities of these respective organizations strongly subsidized by the state;
- the rights of housing owners were practically no different from the rights of tenants in the state housing stockownership rights;
- state enterprises were assigned the function of providing housing to their employees and maintaining this housing.

The progress of housing and communal service sector in Russia is an illustrative example of the complexity and controversial nature of the political and social transformations in Russia in the 1990's. It would suffice to note that the 1992 price liberalization in the period of Gaidar's reforms left this sector of the economy, exclusively undisturbed assigning it the role of a temporary social cushion for the period of market reforms. However, already by the end of 1992 a federal law, *On the Fundamentals of the Federal Housing Policy* <1>,¹ was enacted to establish the key goals of the national housing policy for the period of transition.

The law envisages the key goals of the federal housing policy as: providing social guarantees of the citizens' housing rights; developing private ownership and ensuring protection of the rights of entrepreneurs and owners in the housing sector; promoting competitiveness in the construction, maintenance and repairs of the housing stock and in the production of building materials.

The transition to market relations in the housing sector is associated with changes in the conditions for financing housing and utility services, and with the gradual reduction of budget subsidies to the sector. Article 15 of the Law defines the procedure for a phased transition to a new system of payments for housing and utility services including the necessary measures of targeted social protection of low-income households. Throughout the course of the reforms, this Article has suffered from many political compromises.

The main reform goals for that stage may be defined as follows:

1. *Addressing the issue of housing provision.* First of all, the changes should concern the principle of providing residential premises to the households – from the predominant allocation of housing built with the capital investments of the state to the predominant construction or purchase of housing at the expense of the citizens' funds, retaining benefits for socially vulnerable population groups.

¹ Here and later the references are for the list of literature provided at the end of the report.

2. *Changing the conditions and procedures for paying for housing and utility services.* The fundamental principle of the law is that payments for housing and utility services should cover the costs of housing maintenance and repairs, and utility services, subject to targeted social protection of poor households;
3. *Developing competitive market-oriented approaches for improving housing maintenance and ensuring the preservation of the housing stock.*

Other key regulatory legal documents at the federal level defining the goals of the housing and communal service reforms in the Russian Federation include:

- *The Concept of Housing and Communal Service Reform in the Russian Federation* (hereinafter – Concept) <2>;
- *The Program for Demonopolization and Development of Competition on the Market for Housing and Communal Services in 1998-1999* <3>;
- *The Subprogram “Reform and Modernization of the Housing and Communal Service Complex in the Russian Federation” within the Federal Targeted Program “Zhilische” for 2002-2010* <4>.

The main areas of transformations in the sector, including the time frame for the reform (1997-2003) were identified in the *Concept of Housing and Communal Service Reform*. Pursuant to the Concept, the main goals of the sector reforms are:

- ensuring that living conditions meet the set standards of quality;
- curtailing the costs of service providers and reducing respective tariffs without impairing the quality of the services delivered;
- alleviating the process of rent reform for the citizens upon transition of the sector to loss-free operations.

The main ways of attaining the above goals are:

- improving management, maintenance and control systems in the housing and communal service sector;
- introducing contractual relations, developing competition, providing consumers with the opportunity to influence the volume and quality of the services consumed, predominantly competitive selection of organizations for management and maintenance of the housing stock, provision of materials or equipment for utility companies and design and construction services;
- improving the system of payments for housing and utility services, including the introduction of higher tariffs for housing space and utility services that exceed the established standards, and introducing differentiated payments depending on housing quality and location;
- improving the system of social protection by streamlining the existing system of social benefits and strengthening the targeting of the funds allocated for this purpose.

The purpose of the *Program for Demonopolization and Development of Competition on the Market for Housing and Communal Services in 1998-1999* is to support the formation of a competitive environment in the housing and communal service sector that would effectively

promote the reduction of costs and respective tariffs without impairing the quality of the services delivered. The implementation of the goals and objectives of the *Program for Demonopolization and Development of Competition on the Market for Housing and Communal Services* is directed at:

- finalizing the segregation of the functions of the housing owner, the management company (customer service) and the maintenance company in the state and municipal housing stock;
- introducing contractual relations between producers and customers of maintenance and utility services;
- attracting enterprises of all ownership form to the sector.

It should be acknowledged that the 1998 financial crisis and the reshuffling of the political forces in the country have lead to the curtailment of housing sector reforms that essentially blocked the governmental program and postponed the implementation of the Concept. With the onset of the crisis the housing and communal service sector once again assumed its “cushion” role, curtailing the decline in the population’s incomes. This could not have failed to affect the sector’s economy. Sector enterprises did not have sufficient income to produce the housing and communal services and became, in essence, insolvent.

The financial and technological crisis in the sector in the background of general economic growth in the country called for new solutions, which were reflected in the Subprogram *Reform and Modernization of the Housing and Communal Service Complex in the Russian Federation* adopted by the Government in late 2001 as a part of the Federal Targeted Program *Zhilische*. The subprogram formulates the most topical goals and tasks of the state policy for the housing and communal service sector as of the beginning of 2003.

The main goals of the Subprogram are improving the efficiency, stability and reliability of life-supporting systems, attracting investments to the housing and communal service sector, improving the service quality along with the reduction of costs, and providing targeted social support to the households in payments for housing and communal services.

The main objectives of the Subprogram are:

- improving the financial health of sector enterprises through: (a) restructuring and liquidation of arrears, bringing the tariffs for housing and communal services for the households and other consumers to economically reasonable level; (b) strict compliance with the established payment standards by the households; (c) transition from the subsidizing of housing and utility enterprises and the granting of category-based benefits to the subsidizing of low-income households; and (d) liquidation of cross-subsidized tariffs.
- reduction of costs and increase of the quality and affordability of housing and communal services, formation of the investment attractiveness of the housing and communal service sector through the development of competition for the delivery of housing services, creation of coordinated procedures for tariff regulation of utility companies and natural monopolists – enterprises of the fuel and power energy complex;
- state support for modernization of the housing and communal service complex based on modern technologies and materials in the form of budget funds and state guarantees for attracted investments.

The program documents reviewed above establish the general direction of the housing and communal service sector reforms, consistently declaring the commitment to market-oriented transformations along with the provision of appropriate guarantees for the population. Each of these documents, in turn, poses concrete tasks, the implementation of which should promote the attainment of the general reform goals.

However, actual developments in the housing and communal serviced sector are markedly different from the envisaged goals.

2. Key Trends

Several sustainable positive trends may be identified that allow for the conclusion that despite all deficiencies, the housing sector reform is being implemented in accordance with economic, market-oriented principles. The key positive trends are:

- the appearance of a multitude of private owners of housing as a result of privatization of the state (municipal) housing stock;
- the market for sale and purchase of housing has become an integral part of housing relations;
- the divestiture of departmental housing stock and other objects of social infrastructure to municipalities is almost complete, relieving industrial enterprises from the substantial burden of social functions and thus enabling them to improve the efficiency of operations;
- the unit weight of households' contribution to the payments for housing and utility services has increased substantially, while the share of budget subsidizing of the sector has decreased, but low-income households received targeted social protection;
- Russia has implemented the first targeted social assistance program, the Housing Allowance Program.

At the same time, today it is evident that the overall goal of the housing and communal service reform – improving the quality and reliability of housing and communal services through the development of economic relations in the sector, opening of the sector for private businesses, effective regulation of natural monopolies, stimulating energy saving, and promoting the initiatives of housing owners – has not been attained. For the majority of the population the reform is associated only with higher payments for the housing and communal services. Because this perception of reforms is universal it should be acknowledged that the relatively unsuccessful reform is not the result of poor performance of one local leader or another, but that it represents a systemic phenomenon that calls for analysis and decisions at the federal level.

Before we start our analysis of the reform practices in the housing and communal service sector, let us review the results of a rapid assessment of the financial and economic situation in the sector.

2.1. Finance and Payments²

Based on the established tariffs, the cost of housing and communal services delivered to the housing stock in 2001 is estimated at 360 billion rubles. Residents' payments covered 170.6 billion rubles (47.7 percent), budget funds 129.1 billion rubles (35.5 percent). Thus the deficit may be estimated at 60.3 billion rubles (16.8 percent). This deficit is revealed in two areas:

- failure to pay for services already delivered, primarily heating; in this case the result is higher arrears of housing and power enterprises;
- failure to deliver services or perform works required by the standards and provided for in the tariff rates, the most important item here being capital repairs; this results in the growing depreciation of the housing stock and utility infrastructure, with the costs moved to future generations of users.

² This section uses materials from: Bezhaev O. G., Issues in the Financial Support of Housing and Utility Sector Reforms. Journal of the Manager and Chief Accountant in the Housing and Utility Sector. 2002. September. Part II.

The above balance does not show the effects of cross-tariffs for gas, electricity, water supply and wastewater collection. At first sight, the liquidation of these tariffs should increase the cost of utility services. The reality is more complicated. Cross-tariffs for gas and electricity for the households are subsidized by industrial enterprises (Fig.1). This includes housing and utility enterprises, whose goods and services are paid for by households' payments for housing and utility services. Therefore, gas and electricity to the households is subsidized by other users on the one hand, while on the other hand cross-tariffs for gas and electricity increase the cost of other housing and utility services.

The 2001 budget expenditures have three components:

- tariff rate subsidies (108 billion rubles);
- compensations for benefits to service users (17 billion rubles);
- compensations for housing allowances (4 billion rubles).

The deficit occurs mostly as a result of budget non-payments. For example, total benefits in payment for housing and utility services provided in 2001 amounted to about 50 billion rubles, while only about 17 billion rubles of budget funds were provided (Fig.2). Households' arrears in this period did not exceed 10 billion rubles (Fig.3).

Therefore, financing needs for the housing and utility services to the households in 2001 (based on the effective tariffs) may be estimated at 180 billion rubles, of which 129.1 were actually spent.

However, this figure does not represent total spending for communal services. According to expert estimates (no exact data is available), maintenance and utility services to the buildings of public organizations cost about 80 billion rubles (2001). Of these, 80 percent (about 65 billion rubles) were actually paid. By early 2002, official payables of public organizations amounted to 46 billion rubles.

A special form of budget expenditures is "preparation for winter". Practically no budgets have the item. However, every year, and in the past two years – at an increasing scale, budget funds are used in every legal and illegal way to finance housing and utility enterprises for buying fuel, repairing the nets, replacing boilers, and other works. Most of these expenditures are accounted for in different items, but not in the *Housing and Communal Service Sector* item, while preparations for winter hide in the *Capital Expenditures* item. These expenditures may be revealed in the *Capital Expenditures*, *Fuel*, and other such items in the budget performance reports for 2001. Based on expert analysis, these expenditures may be estimated at 30 billion rubles. As a result, these funds partially and uncontrollably compensate the financial deficit, which, as noted above, exceeded 60 billion rubles in 2001.

Therefore, total budget financing needs of the housing and communal service sector in 2001 equaled 260 billion rubles, actual spending (including preparations for winter) amounted to about 225 billion rubles (2.5 percent of GDP). These figures demonstrate that the state is carrying an excessive burden of social obligations in the area of housing and communal services, and these obligations are poorly fulfilled (by about 86 percent) even in a favorable fiscal year. The hostages of this situation are housing and utility enterprises, which have de-facto become bankrupt due to persistent non-payments of budget funds.

Till the end of 2001, budget expenditures for the housing and communal service sector grew in parallel with the gradually increasing households' coverage of the service costs. For example, in

2001 consolidated budget appropriations across the Russian Federation increased by 22 percent as compared to 2000. This was primarily the result of a better budget payment discipline.

The situation changed substantially in 2002. Households' coverage of the service costs continued to grow, and at a fairly high pace. On the average, by the end of 2002 households in Russia paid 70 percent of the established tariffs for the housing and communal services. As a result, nearly all regions have reduced the share of housing and communal service sector expenditures in their consolidated budgets. For example, as of August 1, 2002 out of all subjects of the Volga Federal District only Tatarstan failed to follow this trend. The tension in the relations with the energy giants has been slightly alleviated. Many jurisdictions financed current payments and debt repayment, though the total volume of outstanding payables of the sector enterprises resumed growth. However, external debts were often repaid at the expense of the financial status of municipal housing and communal enterprises.

Table 1. The share of Housing and Communal Service Sector Item in Respective Budgets

	Consolidated budget of the RF Subjects, %	Municipal budgets, %
January – October 2002	12.6	19.1
January – February 2002	13.9	20.1
January – December 2001	17.5	24.6
January – February 2001	21.2	30.1

At the same time, the cost of housing and utility services to the households increased dramatically in 2002. While the total volume was estimated at 360 billion rubles in 2001, in 2002, according to the information obtained at an extended collegiate meeting of Gosstroï of Russia in Cheboksary on April 2-3, 2003, it reached 512 billion rubles. This rapid growth was explained primarily by the “unfreezing” of the tariff policies of 1998-2000, when in the wake of the financial crisis the stable tariffs once again served as an additional social support under the rapidly changing financial conditions. However, this situation could not last and the critical financial and economic conditions in the sector lead to the reverse process – starting in 2001 prices for the housing and utility services grew faster than consumer price index. (This situation is discussed at length in Section 3.1.)

In 2002, households paid 240 billion rubles for the housing and utility services, that is, the payments increased by more than 40 percent, while the number of participants in the housing allowance program grew by a mere 2 percent to the total of 10 percent (average for the country), which is, evidently, not a critical level.

On the whole, one should note an improvement in the budget discipline of expenditures for the housing and utility sector. Subsidies were financed in the amount of 173.6 billion rubles out of the 180 billion rubles of actually delivered services; benefits got 26 billion rubles out of the required 50 billion rubles; and housing allowances – 12 billion rubles out of the 15 billion rubles of actually originated allowances, according to the expert data of the IUE. The structure of compensations for the expenditures of the housing and utility sector in 2001 and 2002 is presented in Table 2.

Table 2. Expense Structure of the Housing and Utility Service Sector in 2001 and 2002

	2001		2002	
	Provided (bln.rubles)	Paid (bln.rubles)	Provided (bln.rubles)	Paid (bln.rubles)
Total services to the households	360	299.0	512	451.6
Budget:				
- subsidies	127.6	108	180	173.6
- allowances	48	17	50	26
- households	5.3	4	15	12
Deficit	180	170.6	267	240
	-	60.4	-	60.4

The deficit remained the same in absolute terms, decreasing in relative terms from 17 to 12 percent.

Expenditures for utility services to budget-funded institutions increased in approximately the same proportion as the housing and utility payments of the households, and are estimated at 140 billion rubles. However, the payment discipline with respect to these expenditures deteriorated because the 2002 budget priority was declared to be wage increases for the public sector employees. According to the expert estimates, the expenditures amounted to over 100 billion rubles and covered about 75 percent of the services delivered.

Administrative resources were once again mobilized for getting ready for the heating season. Budget expenditures for this purpose are estimated at 40 billion rubles.

Therefore, budget expenditures for the housing and utility service sector in 2002 amounted, according to the estimates, to nearly 400 billion rubles. Of these, financing was provided for 350 billion rubles, or 88 percent of the services delivered. Interestingly, this figure is very close to the level of household payments collection.

2.2. Financial and Economic Status

The financial and economic status of the sector is characterized by the high level of depreciation of capital assets (Fig.4), chronic losses of the majority enterprises (Fig.5), and substantial levels of overdue payables and receivables.

In 2002, losses of housing and utility enterprises exceeded 90 billion rubles. By the end of the year overdue payables reached 280 billion rubles, adding 24 billion rubles more since the beginning of the year. However, overdue receivables amounted to just 185 billion rubles.

Table 3 schematically shows the structure of debts in the sector. Its analysis revealed the following: debts to the energy giants alone (UES and Gazprom) equaled 85 billion rubles, while another 72 billion rubles were equally spread among tax arrears and debts to the state extra-

budgetary funds. Thus total debt equals 157 billion rubles (without accounting for debts to providers of fixed assets, materials, and others). In turn, budget arrears with payments for the utility services delivered to budget-funded institutions equaled 31 billion rubles arrears of the households 45 billion rubles, and arrears of other service users 37 billion rubles, adding up to a total of 113 billion rubles in arrears.

Table 3. Debt Structure in the Communal Sector

Payables	Financial Losses	Receivables
Accounts payable to vendors and contractors	Budget underfinancing	Accounts receivable from institutions financed by all levels of budget
Arrears with taxes and other deductions to the budget	Unbalanced tariff policy	Non-payments of the residents
Arrears with payments to the state extra-budgetary funds	Inefficiency of communal enterprises	Accounts receivable from commercial users
100%	33%	67%

The difference between the figures for receivables and payables indicates double counting. Actually, official statistics gives the debt figure as the sum of the debt of all sector enterprises, which includes mutual settlements between the enterprises. For example, a heating utility may have debt to the water utility, while the latter incur debts to the power supplier because of non-payments for the water delivered to the heating utility. Thus the chain of non-payments results in a double, or even triple count. Analysis of receivables alone gives the figure for the double counting as 72 billion rubles (185 billion rubles – 113 billion rubles). This means that payables without the double counting will amount to 208 billion rubles.

The 95 billion rubles by which the payables exceed receivables reflect the losses of sector enterprises as a result of budget underfinancing, unbalanced tariff policies, and inefficient operations.

Thus, there is a vicious circle: the budget undercollects taxes from the housing and utility enterprises because no budget funds have been provided for the services delivered by these enterprises, while the enterprises incur debts to the budget and contractors because of non-payments from the budget (compensations for the difference in tariffs, excess of the limits by budget institutions). Under these conditions, no real competitive market for the housing and communal services may be formed. The sector has thus become the hostage of the excessive social obligations of the state.

The efficiency of the housing and communal service sector remains extremely low. Moreover, the administrative interference becomes stronger because contractual relations do not work in an unstable financial environment; the sector is characterized by very poorly developed mechanisms of competitive market operations, cost-based tariff regulation of monopoly enterprises, and the high and irrational levels of power consumption. The dominating role of administrative system and the incomplete financing (primarily – out of the budget) eliminate every incentive for reducing unproductive costs.

Many regions have initiated bankruptcy proceedings against utility enterprises. The reasons are either the creditor's desire to acquire liquid municipal property (utility infrastructure) in repayment of the debts or attempts of the local authorities to move fixed assets to a new enterprise with a healthy balance sheet. However, neither option addresses the issue of current payments or accrued debts.

Thus at present the housing and communal service sector is essentially an arm of the administrative apparatus rather than a line of business. It may not evolve into a business unless a political decision is taken for acknowledging and restructuring budget debts, and ensuring current payment discipline, including the budget funds.

2.3. Investments

Starting in the Soviet period, the housing and communal service sector developed at the expense of budget funds. At present, the need for private investments is declared at the policy level, but in reality the sector is still financed by a limited volume of budget resources.

The investment potential of utility enterprises that may be mobilized within the framework of the existing tariff regulation system (depreciation, capital repairs funds, profit) may be estimated at 60 billion rubles annually. This estimate coincides with the estimate of the deficit, because it is this money that is lacking in most cases. However, this investment volume will be absolutely inadequate for a qualitative change in the conditions of the sector. An additional investment potential (technological and managerial inefficiency) is of about the same scale. However, it may be utilized only if a proper system of economic incentives for cost reduction is installed.

The sector's potential attractiveness to investors is based on the nearly fully guaranteed realization of the products and transparent pricing (regulation) rules for the monopolies, enabling investors to minimize their risks. In Russia, tariff regulation is still a disorganized and politicized process. No private investment for the sector will be available unless this problem is addressed. However, even after these problems have been addressed, some time will still be necessary to construct efficient schemes for interaction with the businesses (guarantee agencies, etc.). Thus even according to the "optimistic" forecast of the *Subprogram Reform and Modernization of the Housing and Communal Service Complex* these processes are unlikely to start before 2005.

Therefore, at this time we should work from the assumption that budgetary funds, as well as funds of the enterprises, will be sufficient for financing the most urgent investment programs. Regretfully, these programs more and more often move into the category of "liquidation of the consequences of emergencies", and until the trend for the growing depreciation of the housing stock and utility infrastructure is upturned, this factor should be taken into account when forecasting the need for budget financing.

2.4. Political Environment

The politicized nature of the housing reforms became clearly visible with the beginning of the 2002/2003 heating season. Accidents in the heating nets in several regions "provoked" political activity around this issue. Every political party had its own recipe for "unfreezing" the country. Why all this sudden talk about the "communal catastrophe"? The answer is clear – it is election time. And what is a better way to attract the electorate than a promise of warm homes and low

tariff? Also, mobilizing budget funds for the purpose is not a bad idea – there will be enough money to spend.

The situation in the housing and utility service sector is indeed grave. However, what happened last winter was essentially a normal occurrence. The country has lived this way through every winter since 1999, though the topic of “winter preparations” never leaves the agenda. To the contrary, it moves from “miscellaneous” to the “main issue”.

The spectrum of political solutions is broad. The main battles are fought around two questions: “How much to pay?” and “How to organize the work?”.

As regards the first question, the communists and *Yabloko* have taken a similar stand: to abolish the governmental program, abolish the transition to full coverage of service costs by the households or – as a better option – freeze the tariffs. The Union of Right Forces calls for scheduled tariff reviews with regard for the growth of population incomes, and speaks against the dependence of tariff rates on the political situation and elections, and against bringing the situation to the brink of crisis when the “shock therapy” will be unavoidable.

As regards the second question – organization of the sector – the left wing and, partly, the center demand a stronger direct state interference in the housing and utility service sector with the creation of a management vertical. This position does not stand up under scrutiny. The idea of managing the sector from the federal level resembles the task of boiling the ocean. What is needed is not the management vertical, but clear “rules of the game” for municipalities, businesses, and consumers.

Yabloko and Union of Right Forces advocate the attraction of private businesses and development of competition, the strengthening of stronger control over monopolies, and the promotion of private initiative. However, *Yabloko* and the Union of Right Forces have a diametrically different understanding of these processes.

The *Yabloko*’s recipe is “benefits, benefits, and benefits again” in taxes, tariffs, and every other thing possible for small businesses, for homeowners’ associations, for those who have installed meters. The state coffers are already incapable of compensating the excessive volume of existing benefits. What would happen to the new ones is an easy guess.

The position taken by the Union of Right Forces looks better grounded from the viewpoint of the economy. It is aware that the sector’s problems can not be addressed at the expense of the budget alone. Moreover, local budgets must not be turned into a “dumping ground” of unfunded state mandates. What this sector of the economy needs is: limiting the powers of the monopolies by transparent tariff regulation and auditing; creating a competitive environment and private businesses; attracting private investments, first and foremost into utility infrastructure and energy-saving technologies.

And there is an almost universal drive to “rediscover America”. Each new assertion is often presented as the ultimate truth and a cure for all problems – as if the country has not lived through the ten years of transformations, the ten years on a hard and contradictory road of reforms that includes both mistakes and major successes.

In this context it is important to make an in-depth analysis of the work performed in the past ten years, to identify problems and weak points in the approaches to the formation of the economic relations in the housing and utility service sector, and to determine the ways of addressing these problems.

3. Analytical report

The analysis of the following key aspects of housing and communal sector reform was carried out:

- price setting mechanisms;
- housing and utility payments policy;
- development of competition in the delivery of housing and communal services;
- development of associations of homeowners.

3.1 Price setting mechanisms.

Breakdowns in district heating services in Russia during the truly frigid winters of 2001–2002 and again in 2002–2003 grabbed headlines around the world. Local municipal enterprises that provide the heat claim that they had insufficient resources to maintain distribution pipes and boilers adequately or that they did not have the money to purchase coal or gas to generate the heat. Others believe the problem rests primarily with the inefficiency of the enterprises, which could do much better with the funds they do receive.

In fact, at least five factors determine the quality and costs of providing this type of service:

1. the technical procedures followed by the utility in determining the funds required to provide services, and if necessary expand them;
2. the process at the municipality for reviewing the tariff request made by the utility, including the level at which tariffs are set (adequate or insufficient to do the job);
3. the process at the municipality for acting on the recommendation from the review process;
4. the extent to which payments due to the utility for providing services are actually made (by households, commercial clients, and budget organizations, i.e., local governments and their associated agencies); and
5. the efficiency with which the available resources are applied by the utility.

Generally, municipalities set tariffs for district heat services and for water and sewage services. In the following, we review the formal legal base, cite its shortcomings, and then empirically examine the behavior of a sample of municipalities in setting these tariffs from 1997 to 2002.

We find that little progress has been made in establishing a rational system for setting tariffs, that decisionmaking is highly politicized, and that in times of extreme inflation, tariff increases lag even further behind inflation. To judge from a review of World Bank documents, these problems are common in the countries of the Commonwealth of Independent States but much less so in Eastern European and Baltic countries.³

³ This is based on a review of the descriptions of problems in these sectors contained in Bank project appraisal reports for urban water and district heat projects in the region; in particular, World Bank (1995, 1998a, 1998b, 1999, 2000a, 2001b, 2001c, 2002a, 2002b).

3.1.1 Tariff Reform in the Russian Federation

Under the Soviet system, municipal enterprises providing communal services operated on a cost-reimbursable basis. Investments were funded separately. Cost was divided into two parts: base costs and profit. Base costs covered regular expenses. In addition, certain classes of expenses, such as extra contributions to the employee funds for vacations or training and other “add-ons,” were covered by “profit.” Profit was set by municipal officials as a percentage of base costs, often in the absence of any analysis. These Soviet accounting rules are still in force and have a profound impact on the operations of utilities. Utilities cannot include most investment spending—including interest expense—in base costs, and the share of profits that can be used for investment is strictly limited, as is the maximum profit rate.

It is important to distinguish between two possible cost bases that could be used for regulatory purposes. Under one, the regulations determine tariffs for monopoly communal service firms, particularly water and district heat companies, as the cost of goods (or services) produced (or sold) by these enterprises. Thus, for a water utility it is the cost of a unit of water delivered to the boundary of the customer (e.g., connection to the internal network of a multifamily building). The regulation of tariffs for communal services for Russian households is based on an alternative approach. It differs from the standard western tariff regulation of utility monopolies in three important ways:

- The tariff may include not only the tariff for the services of the utility enterprise, but also the cost of works and services of other organizations engaged in the service delivery (in case of water supply, the cost of maintaining internal building nets, water meters in buildings or apartments, etc.).
- The tariff for services to the households may cover only a portion of the cost of service delivery, with the remainder covered by other sources: the municipal budget (subsidies for the difference between full costs and the tariffs) or higher tariffs for other consumers (cross-subsidization).
- Tariffs for the households typically regulate not just the cost of a service, but also a normative volume of service consumption in cases where metering equipment is unavailable; thus the payment rate for the service equals the value of the regulated tariff multiplied by the regulated normative consumption rate. Metering for residential use of water and district heat, even at the building level, is extremely rare.

In the first days of the transition, the federal government transferred to municipalities the ownership of state housing (mostly of state enterprises), municipal housing, and the communal service assets associated with it. In practice this meant that municipalities became the owners of the great majority of district heat and water-sewerage service enterprises. (As discussed below, some large facilities that co-generate electricity and heat are regulated by the Subjects of the Federation, that is, the regional governments.) The main regulatory document issued in September 1993 on reforming the prices of housing and communal services empowered local administrations to establish tariffs for housing and communal services. It also called for the development of a methodology for the determination of economically reasonable rates and tariffs.⁴ A 1996 Government Resolution confirmed that households should pay the full costs of these services by

⁴ Resolution of the RF Council of Ministers, *On Transition to a New System of Payments for Housing and Communal Services, and Procedures for Granting Compensations (Subsidies) to Citizens for Housing and Communal Services Payments*. (No. 935 as of September 22, 1993).

2003 but again failed to address the structure for setting tariffs. Several subsequent regulations continued this pattern.

It wasn't until 2001 that a regulation was issued that actually addressed the setting of tariffs at the municipal level.⁵ It spoke of the need for tariffs to be substantiated by the production and investment programs of the regulated enterprises. For the first time, it declared the need for developing procedures linking tariff regulation at the municipal and regional levels, and established that the tariff structure should correspond to the system of contractual relations in the housing and communal service sector.

At the end of 2002, the determination of tariffs for municipal communal services was influenced by the federal, regional, and municipal levels of government, because the production of these services involves inputs that have prices regulated by the federal and regional authorities. The effective legislation assigns each level its own regulatory powers. More specifically, the distribution of responsibilities is as follows:

I. *At the federal level:*

- approving the federal standards of the cost of housing and communal services that are used in computing the federal contribution to locally paid housing allowances, which subsidize communal service payments;
- establishing tariffs for electricity and gas delivered to the wholesale market by all participants in this market; and
- establishing limits for fuel and energy consumption by organizations financed by the federal budget.

II. *At the regional (Subject of the Federation) level:*

- regulating tariffs for the electricity, gas, and heat procured on the wholesale market from enterprises of the fuel and energy complex (FEC), for all consumer groups;
- establishing regional prices and tariffs for the electricity and heat produced by large cogeneration plants operating in the region sold on the retail market;
- establishing tariffs for the electricity and heat, as well as water supply and wastewater collection for private enterprises producing these goods and services for sale in the retail market; and
- exercising control over compliance with the existing regulatory legal acts of local governments.

III. *At the municipal level:*

- regulating prices and tariffs for water and heat for municipal enterprises;
- establishing normative rates for the consumption of housing and communal services; and
- establishing rates for households' payments for communal services.

The above listing reveals multiple overlapping authorities. Prominent among these is that the cognizant regulatory agency in the area of heat and water supply depends on the type of owner.

⁵ RF Government Resolution No. 797 of November 17, 2001, *On the Subprogram "Reform and Modernization of the Housing and Communal Service Complex in the Russian Federation" of the Federal Targeted Program "Zhilishche" for 2002–2010.*

Private entities are regulated at the regional level even if they provide services only within a municipality. This creates serious, sometimes irresolvable, problems in attracting private businesses for management of municipal communal infrastructure.

It is important to note that the existing legislation does give some direction to the tariff-setting process by stating that municipalities should establish

rates and tariffs for the housing and communal services (except tariffs for electricity and gas) subject to the implementation of cost-reduction measures as a result of unjustified expenditures revealed through expert examination of the tariffs for goods, works, and services counted in their price. The decision to review the rates and tariffs for the housing and communal services should be preceded by an obligatory expert examination of the economic feasibility of the tariffs for goods, works, and services counted in the price of respective services.⁶

This statement and the assignment of tariff-setting authority to local governments constitutes the entire legislative base.

In addition to these laws and regulations, three methodological documents have been issued by the national government.

1. *Methods for planning, counting and calculating the self-cost of the housing and communal services* (hereinafter – Methods) <9>.
2. *Guidelines for forming economically feasible tariffs for the housing and communal services* (hereinafter – Guidelines) <10>.
3. *Methodological recommendations on the financial substantiation of the prices for water and sewerage* (hereinafter – Methodological Recommendations for Water) <11>.
4. *Methodological recommendations on the financial substantiation of the prices for heat and heat supply* (hereinafter – Methodological Recommendations for Heat) <12>.

The first two comprehensive documents are based on the concept of an economically feasible tariff for a housing or communal service (EFT), which is understood as a fee charged for maintenance or repairs of housing (including capital repairs) or the delivery of a utility service ensuring minimum cost recovery necessary for an expanded reproduction with account for the owner's program for the development of the facilities subject to compliance with the service quality standards. The EFT entails the identification of the production cost, i.e. the self-cost, and the profit required for normal reproduction. It is recommended to calculate expense items based on normative indicators that adjust the current costs to make them more rational, rather than on the actual data for the preceding period.

The Methodological Recommendations for Water pursue similar goals, defining self-cost based on the adopted production and investment programs, effective norms and standards for material, labor, and money costs with regard to the reported data of the organizations for the preceding period. The price of a unit of service is defined as a fraction of the sum of funds and the planned production volume.

⁶ RF Government Resolution No. 707 as of June 18, 1996, *On Reorganizing the System of Payments for Housing and Communal Services*.

According to the Methods, the self-cost of services is calculated based on the data characterizing efficient use of fixed assets, materials, energy and labor resources subject to compliance with the minimum state standards for the service quality.

Despite that all the above documents declare the principle of the priority of financing available for the implementation of an enterprise's production and investment programs, the calculation of the EFT is reduced to calculation of the self-cost and profit based on a certain profitability standard. The main attention is given to item-by-item calculation of the cost of service production, with each item budgeted according to the unit cost standards.

Stated otherwise, these methods presume normative cost-accounting. On the one hand, this approach is appropriate for production processes involving similar or recurring operations, such as water supply, wastewater collection or heat supply. On the other hand, this approach imposed very high requirements on the definition of standards, which should take into account the current state of fixed assets, technologies used, organizational arrangements and qualification of the staff. Moreover, the standards-setting process is not just a determination of some values, but an instrument of motivation. In other words, the standards are designated to address the issues of stimulating cost reduction, improving labor efficiency and quality of the product, etc. However, experience proves that the existing standards fail to address these tasks.

Evidently, it is impossible to abandon the standard-based method in many aspects of the tariff calculation, but it would be unreasonable to give them exclusive attention. This method may be efficient if the standards are periodically reviewed to capture changes in technological and other production factors.

The mechanism for calculating planned profit required for the implementation of the production and investment programs is described ambiguously in both the Methods and the Guidelines. On the one hand, they speak about an absolute sum of the profit, while on the other, for no evident reason, propose to calculate planned profitability rate.

Despite the correctness of the interpretation of many provisions on the application of self-cost calculations, the mechanism for calculating planned profit and others, these documents still:

- ignore the distinction between constant and variable costs in the self-cost calculation;
- do not make it possible to calculate a two-rate tariff for a given service.

Overall, one can say that practically all methodological recommendations reduce the tariff rate calculation to base-costs, disregarding or merely declaring the need to take into account the development goals of the regulated enterprises. These recommendations say nothing about a system of tariff regulation at the municipal level, tariff regulation procedures, etc.

While these methodologies are not binding for local governments, they have gained broad acceptance because of the opportunity they offer to begin to fill the regulatory vacuum.

3.1.2 Tariff Setting in Practice

The result of the weak legislative and methodological foundation provided to municipalities is very poor decision making on tariffs. Specifically, analysis of tariff regulation practices in Russian municipalities reveals several typical problems:⁷

1. Almost universally, tariff regulation acts are a belated response to changes in external conditions for the operation of the enterprises, such as general inflation or increases in electricity tariffs. There is no understanding of tariff regulation as a component of the property management system for utility enterprises.
2. Tariffs are, as a rule, determined as “costs plus profitability.” Being based on cost-tied principles of tariff formation, this system in no way stimulates utility enterprises to control costs.
3. Tariffs are set without accounting for the true investment needs of enterprises. Several vital expense items (e.g., investment projects for expanding production and modernizing fixed assets) may be financed from “profit” only. Since profit is determined as a specified percentage of self-cost, it often turns out to be insufficient both for investment needs and for the financial viability of the firm.
4. The majority of municipalities lack formal tariff regulation procedures. There is no formal definition of the reasons for which a tariff may be reviewed, or of the effective term of tariffs (in the majority of municipalities tariffs are established for an unspecified term). Also absent are tariff application review procedures and procedures for reconciling the needs of the enterprise and the paying capacity of consumers. Tariff review processes are nontransparent and do not provide for the participation of all interested parties.
5. Because no formal procedures are in place, tariff rates turn into an instrument for heads of local administrations or representatives to use for their political objectives. As a result of populist decisions, municipal utilities are deprived of the financial resources they need for normal operations, which leads to depreciation of the fixed assets and reduced service quality.
6. In practically all municipalities the tariff review and approval process is unrelated to the budget process. As a result, the budget is based on the tariff rates effective when the budget is formulated. If tariffs are reviewed and increased during the budget year, the increase results in overdue payables from public organizations.

This is a formidable list of deficiencies, and it will take comprehensive federal legislation to address most of them.

3.1.3 Analysis of the Cost Dynamics of Housing and Communal Services

In the recent time many politicians have spoken about excessive tariffs for housing and communal services and the impermissibility of their further increases. At the same time, no real analysis of the changes in the tariffs for these services has been made. Let us fill this gap and review the changes in the cost of housing and utility services in the past five years. It should be noted that

⁷ This list was prepared by experts at the Institute for Urban Economics (Sivaev et al. 2003). It is highly consistent with World Bank observations. See in particular, World Bank (2000b, 2001a) and Fienkman (1998).

when analyzing the overall structure of the housing and communal services it is critically important to give separate treatment to electricity and gas. These resources represent independent utility services on the one hand, and on the other contribute substantially to the cost of other services (heating, hot and cold water supply). Another important point is that the prices for electricity and gas are regulated in a manner different from the regulation of other housing and utility services.

Cost Structure of Housing and Communal Services

As of the end of 2002 the cost structure of the housing and utility services (per 1 sq.m. of total floor space), taken as an overall average for the country, had the following structure:

Electricity – 9.4 percent;
 Water supply and wastewater collection – 13.6 percent;
 Heating and hot water supply – 48.6 percent;
 Gas – 5.8 percent;
 Housing maintenance – 22.6 percent.

Compared to international practices, the share of housing maintenance in the structure of housing and utility services is low. In international practices it reaches 50 percent. The cost structure in Russia is partly explained by the climate and the highly inefficient energy consumption in the sector. However, the main reason is that at present the payment for maintenance of the housing stock reflects only current costs (albeit in an inadequate volume) and a portion of the costs of capital repairs, but does not include payment for land, funds for renovation and capital repairs, or insurance. The formation of the full structure of a housing maintenance payment would increase its amount by several times.

As noted above, apart from household use, substantial volumes of electricity and gas are used in the production and delivery of nearly all housing and communal services. Gas serves as the main fuel for the production of heat, electricity supports water and heat supply for the housing stock, etc.

Electricity constitutes about 30 percent of the cost of water supply wastewater collection. In the cost of heating, electricity constitutes 7 percent, and in maintenance of the housing stock about 10 percent.

The full share of electricity in the cost of housing and communal services was calculated as follows: the share of electricity is extracted from the share of each service in the cost structure of housing and communal services, and then the figures are added to obtain the cost of indirect consumption of electricity in the cost structure of housing and communal services (Table 4).

Table 4. Indirect Electricity Consumption

Service	Calculation	The share of indirect electricity consumption in the cost structure of housing and communal services
Water supply	$13.6\% \cdot 0.3$	4.08%
Heating	$48.5\% \cdot 0.07$	3.4%
Housing maintenance	$22.6\% \cdot 0.1$	2.26%
Total indirect electricity		9.74%

consumption		
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Adding this result to the figure for direct electricity consumption, we obtain the total share of electricity in the cost structure of housing and communal services:

$$9.4\% + 9.7\% = 19.1\%$$

The adjusted cost structure of housing and communal services will look as follows:

Electricity (direct and indirect consumption) – 19.1 percent;

Water supply and wastewater collection (without the electricity component) – 9.5 percent;

Heating (without the electricity component) – 45.1 percent;

Gas – 5.7 percent;

Housing maintenance (without the electricity component) – 20.3 percent.

Gas consumption in the housing and communal service sector also includes both the direct consumption, and the indirect consumption through electricity and heat power. The share of gas sources in the production of heat amounts to 60 percent. Gas cost in the price for heat produced with the use of gas sources amounts to 35 percent. The share of electricity produced with the use of gas sources amounts to 50 percent. Gas cost in the price for electricity produced with the use of gas sources amounts to 35 percent (Table 5).

Table 5. Indirect Gas Consumption

Service	Calculation	Indirect Consumption
Electricity	$19.1\% \cdot 0.5 \cdot 0.35$	3.3%
Heat	$48.5\% \cdot 0.6 \cdot 0.35$	10.19%
Total indirect consumption		13.5%

The direct and indirect consumption of gas in the cost of housing and communal services amounts to:

$$5.7\% + 13.5\% = 19.2\%$$

The cost structure of housing and communal services adjusted for indirect gas consumption will look as follows:

Electricity (direct and indirect consumption) – 15.8 percent;

Water (without the electricity component) – 9.5 percent;

Heating (without the electricity and gas component) – 34.9 percent;

Gas (direct and indirect consumption) – 19.2 percent;

Housing maintenance (without the electricity component) – 20.3 percent.

As demonstrated by the adjusted cost structure of the housing and communal services, together gas and electricity constitute a substantial portion of the cost – 35%. Because gas and electricity prices are external to the sector's system (i.e., their dynamics is driven by gas and electricity tariff regulation in all sectors of the economy), our forecasts for the changes in the cost of housing and communal services take them into account as individual variables.

For the third variable, we took the growth of the sector's own expenditures. These expenditures were taken into account in the cost structure of the housing and communal services by adjusting the shares of water, heating, and maintenance of the housing stock.

Thus the cost dynamics of the housing and communal services was calculated on the basis of three components, which change following different patterns: growth of prices for gas, electricity and growth of the sectors own expenditures.

Retrospective Analysis of the Cost of Housing and Communal Services

From 1998 to 2001 prices for housing and communal services fell behind inflation. The gap was the greatest in 1998 when the annual inflation reached 84 percent, while the prices for housing and communal services grew by only 12 percent.⁸ Annual inflation in 1999 equaled 36.5 percent, while the prices for housing and communal services grew by only 25 percent. The immediate consequences were low attractiveness of jobs in the sector, high debts to suppliers, and lack of competitiveness. Subsequent dynamics of the prices for the housing and communal services shows that the response to this critical situation came in the form of faster tariff growth, which for the first time exceeded inflation in 2002.

It should be noted that in 1998-1999 prices for electricity grew even slower than prices for the housing and communal services. As with the housing and utility enterprises, electricity producers were forced to curb their current expenditures in the period of high inflation. However, starting in 2000, the growth of electricity prices outpaced inflation, enabling the sector enterprises to provide relatively normal financing of their current expenditures. Unlike the housing and utility enterprises, since 2000 electricity producers have been able to reduce deferred expenditures because the electricity prices grew faster than inflation. In the housing and communal service sector the compensation for deferred inflation is just beginning, and because in the past four years prices for the housing and communal services were kept below inflation levels, the accumulated effect of deferred inflation grew higher and higher (Table 6)

Table 6. Growth Dynamics of the Cost of Housing and Communal Services, and Electricity

Year	CPI	Average cost of housing and communal services in Russia per 1 square meter	Growth of electricity prices	Gas	Growth of prices for housing and communal services
1998	184.5	9.2	102.2	108.6	112
1999	136.5	11.5	119.7	113.6	125
2000	120.2	12.8	141.7	162.0	111.3
2001	118.6	14.2	137.0	129.0	110.9
2002	115.7	19.1	125.0	130.0	134.5

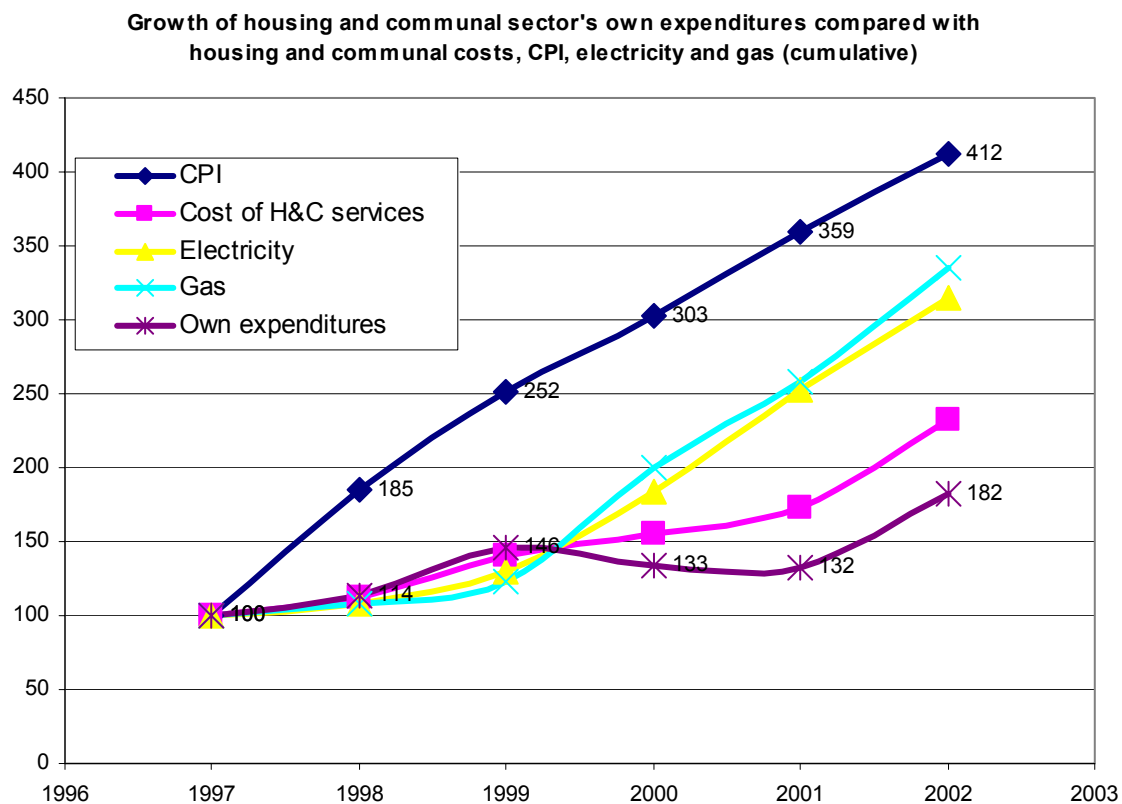
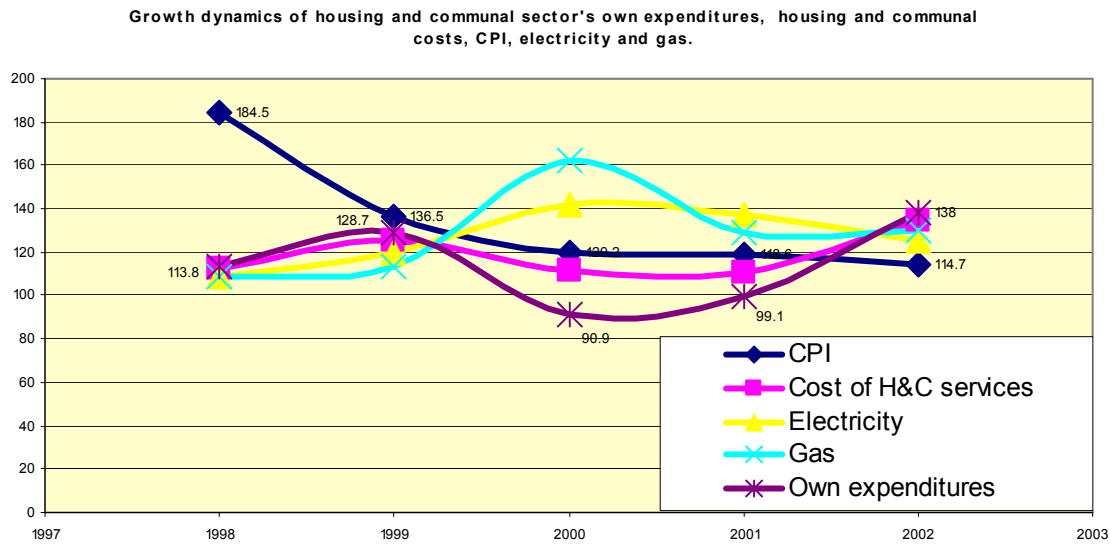
Therefore, from 1998 to 2001 prices for the housing and communal services grew much slower than inflation. The sector was used as a cushion against the high inflation of 1998-1999. Keeping the cost of housing and communal services low in the period of high inflation, the government

⁸ In this research, the cost dynamics was analyzed with the use of the federal standards for the cost of housing and communal services, which are approved by the RF Government on an annual basis. Despite the certain conditionality, this indicator allows for demonstrating and evaluating the key trends.

tried to preserve social and fiscal stability at the expense of deterioration of the financial and productive status of the sector enterprises. As a result, enterprises were unable to finance their current and capital expenditures, and had to dig deeply into their capital assets.

Another consequence of this situation was the slowing of the economic transformations in the sector. The “programmed” underfinancing made administrative intervention necessary. The resource shortages, which theoretically should have promoted energy saving and general efficiency, in reality resulted in the freezing of these processes.

In 2002, the effect of deferred inflation finally struck back. The growth of prices for housing and communal services exceeded inflation by 20 percent. Of this, 12 percent is attributed to the sector’s own expenditures, excepting gas and electricity. Total inflation for 1998-2001 was 2.86 times higher than growth of prices for the housing and communal services. Stated otherwise, prices for these services fell behind inflation by 186 percent. The faster price growth in 2002 could compensate only 20 percent of the deferred inflation.



Deferred inflation may be calculated in the following way.

First, we take data on the average cost of housing and communal services per 1 square meter per month from 1998 to 2002. Then we assume that increases in the average cost of housing and

communal services per 1 square meter per month equal actual price growth. Then, because the housing and communal services include direct and indirect consumption of gas and electricity, these components should be excluded to obtain the growth rates for own expenditures in the housing and communal service sector.

In order to make such calculations, we need data on the cost structure of housing and communal services in the period from 1998 to 2002 (Table 7).

Table 7. Cost Structure of Housing and Communal Services in the Period from 1998 to 2002 (%)

	Electricity	Water	Heat	Housing Stock	Gas	Direct and indirect electricity consumption	Direct and indirect gas consumption	Total share of gas and electricity
1998	6	13	52	26	3	13.2	17.1	30.3
1999	6	13	52	26	3	13.0	16.8	29.8
2000	7	13	50	24	5	14.4	18.4	32.8
2001	9	14	49	23	6	15.8	19.5	35.3
2002	9	14	49	23	6	15.3	19.1	34.4

Knowing the value for the direct and indirect consumption of gas and electricity, we can calculate the growth of own expenditures in the housing and communal service sector from 1998 and 2002 with the use of the formula:

$$Y_i = (C_i - E_i * x_{ie} - G_i * x_{ig}) / (1 - x_{ie} - x_{ig})$$

Where:

Y_i – growth of the sector's own expenditures (without gas and electricity) in the period i ;

C_i – growth of the average federal standard for Russia in the period i ;

E_i – growth of electricity prices in the period i ;

G_i – growth of gas prices in the period i ;

x_{ie} – share of electricity in the cost of services in the period i ;

x_{ig} – share of gas in the cost of services in the period i .

Using this formula, we derive the price dynamics for the services provided by the housing and communal service sector (Table 8).

Table 8. Comparative Dynamics of Own Expenditures, Electricity Prices, and CPI

	CPI	Electricity	Gas	Own Expenditures
1998	184.5	108.6	108.6	113.8
1999	136.5	119.7	113.6	128.7
2000	120.2	141.7	162.0	90.9
2001	118.6	137.0	129.0	99.1
2002	114.7	125.0	130.0	138.0

Then, to find the effect of deferred inflation, we calculate growth of CPI and service prices in a running total to obtain the figure for the delay in the price growth (by the number of times) (Table 9):

Table 9. The Deferred Inflation Effect

	CPI, running total	Growth of service prices in running total	The deferred inflation effect in running total (delay in the growth of the housing and communal service sector, by the number of times)
1998	184.5	113.8	1.62
1999	251.8	146.4	1.72
2000	302.7	133.1	2.27
2001	359.0	131.8	2.72
2002	411.8	182.0	2.26

According to the data in the last column, by 2003 inflation outpaced prices by 2.26 times. The effect was already evident in the 2002 prices for housing and communal services, as a result of which growth of own expenditures in the sector exceeded inflation by 24 percent.

The above analysis of the cost of housing and communal services disproves the assertion about the accelerated growth of prices for the services of the housing and utility complex, and largely explains the dire financial and technical situation in the sector. From the economic viewpoint, in this context an accelerated growth of prices for the services in order to liquidate the “deferred inflation” could result in substantial improvements of the sector’s finances. However, 2003 and 2004 are the years of federal elections in Russia, and it is quite obvious that political considerations shall prevail over economic reasoning.

3.1.4 Statistical Analysis

The broad findings outlined above are widely accepted. In this section we formulate specific hypotheses about the local tariff-setting process and then test them with data from nine cities.

Hypotheses. We have formulated three hypotheses based on the foregoing analysis.

1. Decisions on increasing tariffs are deferred until elections are over.
2. Municipalities in which tariff review decisions are the responsibility of the local legislature (Duma) are less willing to review and increase tariffs.
3. Local authorities use tariff policy to shelter the population from the adverse impacts of the transition on household incomes, particularly in periods of very high inflation.
4. Activities of the regulatory authorities of different levels of governments are not coordinated

Obviously, these hypotheses do not cover the entire spectrum of the problems reviewed earlier. Testing them, nevertheless, may provide insight into the current situation in municipalities.

Variable Definitions and the Data Employed. To test these hypotheses, the following model was estimated for four dependent variables: the ratio of a tariff index (January 1997 = 100) to the consumer price index (same base) for heat and water services, for residential and industrial users. The mean values of the four variables are:

Water–households	.90
Water–industry	.67
Heat–households	.58
Heat–industry	.51

The general reluctance to raise tariffs is clear from these figures. The cumulative shortfall in maintenance and investment to renew systems suggested by these figures is large indeed. Since heat costs are much greater for households than water costs, the figures also indicate that the overall lag of tariffs for residential users behind inflation was probably around one-third during this period. The lower average rate of increase for industrial tariffs compared with those for households in part reflects a national policy of moving toward a unified tariff for each service. During the Soviet period, industrial users faced tariffs several times those of households, and the new policy is designed to make Russian industry more competitive. Even in 1996 in Perm, for example, water tariffs for industrial customers were 20 times greater than those for residential users; by February 2002 the ratio had fallen to about 6. The higher rate of increase shown above for residential users compared with industrial users suggests this policy is being implemented.

The independent variables employed in the analysis are listed in Table 10 along with a summary rationale for each included in the model.

Table 10. Independent Variables Included in the Analysis

Variable	Definition/Rationale	Mean value
D	Var = 1, if the city Duma approves tariffs. Resistance to increased tariffs is greater if the Duma, rather than the mayor, approves tariffs.	0.90
EL	Var = 1, during the six months prior to an election. Pressure exists during all elections for the political parties not to anger voters with tariff increases.	0.33
A	Var = 1 when the rate of monthly inflation is greater than 3 percent. Municipalities are likely to use restraint in increasing housing and communal services costs to consumers as a “shock absorber” during periods of extreme inflation. The main inflation spike was after the 1998 ruble devaluation.	0.20
E	Index for electricity tariffs (Jan. 1997 = 100). Electricity is an important component of operating costs for both water and heat. Because there is no coordination between regional and municipal authorities on the timing of tariff increases, there is no	167

Variable	Definition/Rationale	Mean value
	firm expectation about the sign of the coefficient.	
C_i	Series of dummy variables for the included cities to capture city-specific effects. Omitted city is Cherepovets; see text for further explanation.	

Cherepovets was selected as the base city (omitted category) because it differs from the other cities in two important respects because of reforms implemented in 2000.

1. It is one of the few cities in Russia with a logical system for regulating the tariffs of its housing and utility enterprises that takes into account the needs of both regulated enterprises and consumers.
2. It has abandoned the practice of budget subsidies for housing and utility enterprises, thereby increasing the total revenues of the enterprises (because the government was often delinquent in its gap-filling payments) and strengthening the targeting of the remaining subsidies, which are allocated through a means-tested housing allowance program.⁹

To estimate the model monthly data on tariff levels, various events were assembled for nine cities for the period 1997–2001: Perm, Izhevsk, Petrozavodsk, Cheboksary, Yuzhno-Sakhalinsk, Ulyanovsk, Yoshkar-Ola, Magadan, and Cherepovets. These cities are drawn from several Russian regions, including European Russia (Cherepovets), the Urals (Perm), and the Russian Far East (Yuzhno-Sakhalinsk, Magadan). The cities have exhibited sharp differences in their interest in housing and communal sector reforms over the years. For example, while Cherepovets and Petrozavodsk have been progressive in housing and communal services reform generally, Ulyanovsk strongly resisted adopting reforms until two years ago, when it was forced to begin by its virtual bankruptcy. While the cities were selected, to some extent, for their diversity, they do not constitute a representative sample.

The authors had good working relationships with these cities and could collect the necessary data for the analysis from local administrations. In Perm, Cheboksary, and Yuzhno-Sakhalinsk, data on electricity tariffs were not available. Consequently, only six cities are used in the analysis of water tariffs, where electricity is a very important input. Models with and without the electricity variable are estimated for district heat tariffs (i.e., samples of six and nine cities, respectively). With electricity accounting for less than 10 percent of the production costs for district heat, estimating both specifications seemed reasonable. Since the data is monthly, the total observations range between 360 and 540.

Results

The results, presented in Table 2, generally confirm the hypotheses set out earlier, but the patterns are complex. Six estimated models are included—one each for household water and industrial water tariffs and two specifications (and samples) for district heat tariffs. The two sets of district heat models differ in the inclusion of the variable indicating an increase in electricity tariffs.

⁹ These innovations are described in Sivaev et al. (2003). The housing allowance payment is operational throughout Russia. For information on it, see Puzanov (1997) and Struyk, Lee and Puzanov (1997).

The results attest to the impact of municipal Dumas' reluctance to raise water tariffs. For example, for residential users, the ratio of the tariff index to inflation falls by 0.41, a decline of nearly half of the average value when a Duma must vote on the increase. On the other hand, the Dumas' reluctance is not evident in heat tariffs. Indeed, if anything, they seem more willing to increase heat tariffs, particularly for industry, than are municipal administrations.

The hypothesis that tariff policy works to cushion the blow of severe inflation on household and industry well-being is clearly supported: The dummy variable is highly significant in all six models.

The impact of elections is more modest than we had expected. Interestingly, after controlling for other factors, upcoming elections seem to have no influence on the level of water tariffs for households. On the other hand, tariffs for industrial users for both water and heat (in the model including the electricity variable) are maintained during the run-up to elections. One interpretation is of a possible quid pro quo between election contributions and the cost of doing business. Nevertheless, the coefficients of these variables are fairly small, suggesting that, after controlling for other factors, the reductions are modest.

The fourth hypothesis, "activities of the regulatory authorities of different levels of governments are not coordinated" is also confirmed by the results of the regression analysis. In all cases where the independent variable for electricity was included its coefficients had significant values. On the whole, low values of the b coefficient indicate that increases in electricity prices did not lead to reviews of the heat and water tariffs. While one could expect the electricity tariffs to push up tariffs for water and heat, the analysis showed that municipalities often ignored the growth of electricity tariffs when approving the tariffs for heat and water. These policies resulted in a universal accrual of debts by the housing and utility enterprises to the energy companies. Consequently, the activities of tariff regulators were uncoordinated. An additional obstacle to tariff reviews during a quarter after an increase in the electricity tariffs may be the slowness of the tariff regulation system. Given the current tariff review procedures, one quarter may be insufficient for approving the new tariff rates.

The results of the increase in electricity tariffs are highly significant in all four models where it is included. The small quantitative effect is negative. One might have expected the opposite (i.e., higher electricity tariffs pushing up municipal tariffs). The negative sign could be interpreted as demonstrating the lack of coordination between regional and municipal governments in tariff setting.

It is also worth noting that during much of the analysis period, local utilities piled up huge debts to the national electricity monopoly. This means that the electricity rate increases may not have mattered much to some of the municipal utilities—a story consistent with the negative sign.

Table 11. Estimated Regression Models

	Househol d water tariff	Industry water tariff	Househol d heating tariff	Industry heating tariff	Househol d heating tariff	Industry heating tariff
(Constant)	1.103	1.356	0.361	0.304	0.688	0.786
	13.237*	27.820	9.737	10.236	8.592	15.292
Election hypothesis	0.022	-0.046	-0.034	-0.028	-0.063	-0.062
	0.543	-1.888	-1.095	-1.095	-1.430	-2.198
Duma factor	-0.405	-0.169	0.123	0.376	-0.042	0.131
	-4.609	-3.290	1.808	6.881	-0.506	2.468
Inflation jumps more than 3%	-0.118	-0.081	-0.130	-0.106	-0.155	-0.141
	-3.025	-3.545	-4.548	-4.621	-3.867	-5.476
Perm	-	-	0.241	0.045	-	-
	-	-	3.353	0.780	-	-
Izhevsk	0.139	-0.297	-	-	-	-
	1.643	-6.023	-	-	-	-
Petrozavodsk	0.937	-0.165	0.118	-0.083	0.128	-0.068
	11.111	-3.345	1.635	-1.449	1.620	-1.335
Cheboksary	-	-	0.171	-0.029	-	-
	-	-	2.373	-0.511	-	-
Yuzhno-Sakhalinsk	-	-	0.255	0.054	-	-
	-	-	3.540	0.939	-	-
Ulyanovsk	1.513	-0.359	0.261	-0.028	0.304	0.036
	17.836	-7.236	3.627	-0.481	3.804	0.694
Yoshkar-Ola	0.573	-0.218	0.357	-0.036	0.330	-0.075
	7.198	-4.675	5.266	-0.659	4.411	-1.562
Magadan	-0.205	-0.537	0.188	0.299	0.082	0.142
	-3.300	-14.785	3.845	7.654	1.400	3.772
Electricity tariff growth	-0.002	-0.001	-	-	-0.001	-0.002
	-6.001	-6.151	-	-	-4.717	-10.886
R2	0.744	0.473	0.248	0.292	0.312	0.499
F-stat	113.186	34.954	15.496	19.328	16.484	36.219
n	360	360	540	540	360	360

* t-statistics appear below the coefficients.

The inclusion of the electricity variable has significant impacts on the magnitude and significance of the coefficients of other variables in the models for district heat. This result holds when the sample of cities included in the regression where electricity tariffs are excluded is the same as in the regression where the variable is included. The variable for elections is significant for the models that include electricity. The coefficient of the Duma variable and many of the city-dummy

variables change sharply. This argues for the importance of controlling for the actions of regional authorities in analyzing municipal tariffs.

A number of the city-dummy variables are statistically significant and impressively large. Interestingly, there is not much of a clear pattern in the signs of these variables, either for the same city across the four tariffs or for all the cities in a single model (i.e., relative to Cherepovets). For example, in the model of household water tariffs, the coefficients for Petrozavodsk and Ulyanovsk are positive, very large, and highly significant. But the coefficient for Magadan is highly significant, small, and *negative*. Two reasons for the high variability in the results for the city variables seem plausible. First, Cherepovets adopted its exemplar practices only in the past couple of years, so it is not a steady reference point for the other cities. Second, tariff policy in many cities has been highly variable, shifting dramatically with changes in administration and the posture of presidential administrations in Moscow.

Testing the Hypotheses in Surveys

The hypotheses formulated for testing with the use of regression analysis techniques were further tested in the course of the survey of municipal administration officers professionally interested in the management of the housing and communal services sector and the regulation of tariffs for the housing and utility services. The interviews were taken under the condition of anonymity.

The first question was about the factors that have the most important influence on tariff review decisions at the municipal level. In the opinion of the respondents, the main influences are the need to modernize fixed assets and improve service quality, as well as changes in the financial needs of the enterprises as a result of higher energy prices.

Other reported reasons for tariff reviews are substantial volumes of outstanding payables and the need to improve service quality. Characteristically, none of the respondents stated termination of the effective tariff period as the reason. This is indicative of the dominating practice of setting tariffs for an indefinite term.

The next question concerned the politicization of the tariff regulation process. An overwhelming majority of respondents admitted one or another degree of politicization. The main politicization factors were identified as election campaigns and the adoption of tariff rates by the legislative arm of municipal governments. Some respondents reported a growing understanding of the sector's woes among the City Duma deputies, and cases when unpopular measures have been taken, though such cases are rare. Interestingly, even a respondent from Cherepovets, which has the most efficient tariff setting process, declared that the process was 100-percent politicized. The only person who asserted that no politicizing is in place chairs the tariff commission. Evidently, this respondent is an interested party, and the opinion expressed may not be regarded as objective.

The respondents were then asked to what extent the tariff policy is responsible for the current status of the enterprises (technical condition of fixed assets, financial health). Summarizing the answers, one may say that the respondents did not see tariff policy as the sole reason for the dire state of enterprise assets. Other "contributors" were budget underfinancing and poor management, though the respondents gave different weights to these factors. Speaking about the tariff policy *per se*, the respondents stressed the cushion role of sector enterprises that had ensured public content for many decades. *"The current state of the enterprises is a direct result of the many decades of*

tariff-freezing when the tariffs served as a cushion ensuring public content,” – noted one respondent from Rostov oblast.

Several responses stated that the poor state of fixed assets is caused by lack of professional specialists because the salaries in the sector are unable to retain people of required qualification. For example, it was noted that the rank 1 rate for the sector employees is 405 rubles, while specialists of the same qualification in other organizations are paid 1,200 rubles. Accordingly, many specialists left, *“the remaining ones are over 50, and young people stay away from the sector that has lost its prestige.”* (Rostov)

The respondents were unanimous on the issue of fixed-term (1 year) tariffs and mandatory tariff reviews at the end of this period. All responses were positive. Additionally, wishes were expressed that the proposed term (1 year) be regarded as minimal, and that the regulators should seek to establish longer periods (2-3 years) to enable enterprises to make efficiency investments and recover the costs.

Similarly, all respondents agreed that the legislation should include a list of grounds for mandatory tariff reviews. Responses to this question also indicated the need for legislation that would prove for automatic tariff adjustments upon changes in energy prices.

Opinions about the need to mandate public hearings for each tariff review were more mixed. Evidently, some respondents are unclear about the purpose of public hearings. From their responses it may be deduced that they understand public hearings as a direct discussion of the tariffs with all stakeholders, though public hearings are just a way of informing the public about the state of affairs in the sector and the tariff policy. Also, an opinion was voiced that the population is not ready to take part in such events because *“these issues are very difficult for a common person”*. (Yoshkar Ola)

Some respondents voiced concerns that public hearings would give the public community the opportunity to influence tariff rates, and that residents or their representatives would be invited to vote on tariff decisions. At the same time, the majority of the respondents recognized public hearings as a usable measure if intended to inform the public about the reasons behind the tariff rates. Moreover, they admitted that informing the public about the tariff policy could help alleviate the social tension. Several examples are given below.

“Importantly, the hearings should make the people understand that a low tariff rate would result in accidents and service interruptions. The hearings should have nothing in common with a vote.” (Cherepovets)

“The public should have access to the information about what made one or another tariff necessary.” (Rostov Oblast)

“Public hearings are necessary to give citizens an understanding of what is going on.” (Orenburg)

“Public hearings should take place, but they should not affect the rate levels; rather, they should provide informational support. Tariffs are first and foremost economics, not voting.” (Yuzhno-Sakhalinsk)

Some responses contained complaints about the unavailability of mechanisms for informing the public about the tariff in some regional regulatory systems and the information substantiating the tariff rates approved by regional energy commissions. (An example: *“We are not informed about what makes tariffs for gas and electricity grow.”*) At the same time, several respondents noted the

public hearings held by regional energy commissions as an example of the type of practices to be replicated by municipalities.

All respondents were positive about the need to install coordination into the tariff decisions of the regulatory authorities at all levels (federal, regional, municipal) and tie tariff formation to the budgetary process. Many instances of tariff hikes for the heat and power energy produced by enterprises of the Unified Energy System of Russia were reported after the budget had been approved. In the opinion of several respondents, tariffs may be changed during the budget year only in case of a force majeure.

And finally, most respondents were unable to identify the best incentive for municipalities to pursue “good” tariff policies. Some noted that such incentives might include a clear delimitation of the powers of different levels of government, predictable fiscal relations, and a unified regulatory base for the tariff-setting process. Also named was the need to match financing and the volume of services to be produced.

3.1.5 Conclusions

After reviewing the analysis presented, it is little surprise that the past two winters have witnessed frequent crises in the provision of water and heat services in Russian cities. Over the past several years, tariffs for these services have increased at a fraction of inflation, and the bills based on these tariffs have often gone unpaid by local governments. The statistical analysis presented here confirms the highly politicized decisionmaking on tariff increases. It also indicates that tariffs have been restrained as a “shock absorber” to mitigate the impact of surges in inflation on the population.

Politicization has taken place on two levels. The first is at the local level, as we have seen. But this pattern could not have been sustained without the complicity of national energy monopolies in tolerating unpaid bills from local communal service enterprises—and ultimately the municipalities. This policy began to be reversed only after the election of Vladimir Putin.¹⁰ Unfortunately, the Russian government has displayed great reluctance to take decisive action to put tariff setting on a rational footing, both in determining appropriate rates and in adopting them. Until this is done, more winters of crisis are likely in store.

¹⁰ See Hough (2001) for an excellent discussion of this implicit policy during the transition.

3.2. Housing and Utility Payments Policy

3.2.1 Analysis of regulatory and legal basis of the transition to a new system of payment for housing and utility services.

Before adoption of the Law "On Foundations of the Federal Housing Policy", of December 24, 1992 (hereinafter - the Law "On Foundations ..."), payment for housing and utility services was regulated mainly by the norms set by the RSFSR Housing Code of July 24, 1983. The procedure of payment for use of residential space in state¹¹ and communal housing relied on state subsidies for expenses on maintaining state and communal housing, which greatly exceeded payments made by population. The state was spending huge amounts on subsidies to housing and utility sector, with very low return. Housing and utility payments made by the population could not compensate these expenses. Rent payments were collected in accordance with the Decrees of All-Soviet Central Executive Committee and Soviet of People Commissars of RSFSR "On Housing Payments in Cities and Worker's Settlements" of May 14, 1928, and "On Housing Policy" of January 4, 1928, which set the rate of rent payments at RUR 0.132 for 1 square meter of residential floor area, and for buildings with improved comfort conditions - at RUR 0.165 for 1 square meter (i.e. 25% higher). These rates did not change for over 60 years and amounted to about 2% of a household income (4% together with utility payments). In 1992, residents' payments covered only 1% of maintenance and repair costs of state housing, and only 8% of utility services costs. This method of payment for use of housing was not in line with the principles of the country's transition to market economy.

Principles of the new system of payment for housing and utility services.

With the adoption of the Law "On Foundations ..." the procedure of compensating the expenses on housing stock maintenance was changed. Pursuant to Article 15 of the Law "On Foundations ...", payment for housing and utility services under a rent agreement is set in the amount covering the cost of maintenance and repair, as well as utilities. Thus, federal law declares the principle of full coverage of costs of maintenance and repair of housing and utility services with payments of residents, who occupy residential space in state and communal housing under social rent agreements¹². Transition to the new system of housing and utility payments is aimed at compensation of the actual cost of housing and utility services by consumers and implies simultaneous introduction of targeted social assistance to families, depending on their income. Thus, in 1992, it was declared that **the goal of housing and utility payment reform is the transition to full coverage of costs by residents' payments with simultaneous social protection of low-income families.**

Pursuant to Paragraph 2 of the Resolution of the Supreme Soviet of the Russian Federation "On Enactment of the Law of the Russian Federation "On Foundations of Federal Housing Policy"" of

¹¹ At that time, "municipal" type of housing was not yet introduced. Absolute majority of residential buildings and 100% of apartment buildings belonged to the state housing stock (Art 5 of RSFSR Housing Code).

¹² Later, the Government of the Russian Federation applied the same principle to owners of housing.

December 24, 1992, previously adopted legislative acts of the Russian Federation and subjects of the Russian Federation can be applied as long as they do not contradict the Law "On Foundations ...". Therefore, the use of provisions of the Housing Code of RSFSR was limited and the Code occupied a less important position in the hierarchy of legal acts regulating the procedure of housing and utility payments.

Legislators assumed that introduction of full payment for housing and utility services by the population with simultaneous social protection of population would result in significant decrease in budget expenses, as the need to provide subsidies to housing and utility enterprises would be eliminated and budget expenses would only be associated with compensation of benefits and allowances provided to citizens.

Terms and stages of transition.

Article 15 of the Law "On Foundations ..." stated that the transition to the new system of payment for housing and utility services should be done in stages within 5 years, i.e. from 1998 all budget subsidies to housing and utility enterprises should have been terminated, while consumers should have paid full cost of services. The transition should be done in stages, and the stages and the order of transition to the new system of housing and utility payments is determined by the Government of the Russian Federation together with authorities of the subjects of the Russian Federation.

The principle of full coverage of the costs of maintenance and repair of housing and utility services by residents' payments, established by the federal law, is further regulated by the Resolutions of the Government of the Russian Federation, which describe in detail the procedure for implementation of the new payment system and set forth additional social guarantees for the population.

On the grounds of Article 15 of the Law "On Foundations ...", the Resolution #935 of the Government of the Russian Federation of September 22, 1993 "On Transition to New System of Payment for Housing and Utility Services and Procedure for Providing Compensation (Allowances) to Citizens for Housing and Utility Payments" (Paragraph 1) sets the terms of stage-by-stage transition to the new system.

In addition to Resolution #935, another Resolution of the Soviet of Ministers of the Russian Federation (#1329, of December 23, 1993) "On Supplementing the Decree #935 of the Government of the Russian Federation, of September 22, 1993" authorized executive authorities of the subjects of the Russian Federation to establish the level of residents' payments for maintenance and repair of housing and utility services as percentage of cost, for each year and each region (city), depending on the current financial situation and possibility of providing compensation (allowances) to citizens for housing and utility payments from the budgets of the subjects of the Russian Federation, with the goal of reaching the 100% level of residents' payments by 1998.

In 1994 - 1995, tariffs for housing and utility services were growing at such a quick rate that they were no longer lagging behind the inflation rate. In these years, the share of housing and utility

costs covered by the population increased from 2 - 3 % to 20 - 40 %¹³. In 1995, real income of population fell by 13%. As a result, politicians reconsidered their approach to the reform of housing and utility payments and extended the deadline for transition of housing and utility sector to full self-sufficiency.

Federal Law # 9-FZ, of January 12, 1996, "On Introduction of Changes and Amendments to the Law of the Russian Federation "On Foundations of Federal Housing Policy" has changed the initially established five-year term of transition to the new system to a ten-year term. Thus, pursuant to federal law, the deadline for transition to full coverage of costs of maintenance and repair of housing and utility services by payments of residents occupying residential space in state and municipal housing under social rent agreements was moved to 2003.

Following the State Duma, in 1996, the Government of Russia decided not to set a unified maximum level of residents' payments for housing and utility services. Paragraph 6 of the Government Resolution # 707, of June 18, 1996, recommends that executive authorities of the subjects of the Russian Federation set the level of residents' payments for housing and utility services as percentage of housing and utility costs for each year of the transitional period. Such regulation of terms of stage-by-stage transition to the new payment system should have been performed on the basis of suggestions of local self-governments, depending on the current financial situation. Due to the fact that Paragraph 7 of this Resolution authorizes local self-governments to set tariffs for housing and utility services, the level of residents' payments, established by executive authorities of the subjects of the Russian Federation, can be used only for inter-budgetary relations between region and municipalities.

Timeframe for the reform of housing and utility payments (1997-2003) was fixed by the Concept of Housing and Utility Sector Reform, approved by Presidential Decree # 425, of April 28, 1997, "On Housing and Utility Sector Reform in the Russian Federation". However, in this new stage, the Concept placed the main focus not on raising the tariffs for housing and utility services, but on lowering the costs of service providers. The Concept indicated that crisis should be resolved by way of changing the system of financing, i.e. by moving from budget subsidizing to full coverage of housing and utility costs by consumers, while providing at the same time social assistance to low-income families and economic incentives for improving the quality of services. In other words, the Concept suggested sharp reduction of budget expenditures (first of all, the expenses of the state) and corresponding increase of expenses of the population.

In 1999, the State Duma once again decided to move the deadline for transition to full payment for housing and utility services. Pursuant to Federal Law # 113-FZ, of June 17, 1999, "On Introduction of Changes and Amendments to the Law of the Russian Federation "On Foundations of Federal Housing Policy", the transition to the new system of payment for housing and utility services shall be performed stage by stage within 15 years, i.e. by 2008.

This Federal Law added the following provision to Article 15: "During the period of stage-by-stage transition to the new system of payment for housing and utility services, the Government of the Russian Federation shall continue to observe the procedure for providing subsidies (transfers)

¹³ According to data of Gosstroy of Russia, in 2002, the share of residents' payments amounts to 52.3% of housing and utility costs.

to budgets of the subjects of the Russian Federation for maintenance and repair of housing and facilities of the housing and utility sector in the amount not covered by residents' payments". Thus, the state has declared for the first time its obligation to compensate a part of expenses of regional budgets, which are used to cover the losses of housing management, housing maintenance, repair, construction, utility and specialized organizations, resulting from state regulation of prices for housing and utility services.

RF Government Resolution #877, of August 2, 1999, "On Improving the System of Payment for Housing and Utility Services and Measures of Social Protection of Population" (Part 2, Paragraph 8) authorizes local self-governments, during the period of transition, to set the maximum allowable share of household expenditures for housing and utility payments by total family income, as well as amount of residents' payments for housing and utility services provided. At the same time, the Government recommends that, for the purpose of improving social protection of low-income population groups, local self-governments set the amount of payment for housing and utility services within the limits of the federal standard of maximum allowable share of household expenditures for housing and utility payments by total family income, per person. Thus, the Government has consented to the fact that actual terms of transition to full coverage of housing and utility costs will be determined at municipal level.

Distribution of authority on setting the rates of housing and utility payments for the population.

Pursuant to Resolution # 935 (Paragraph 5), local administrations are authorized to approve norms of consumption for housing and utility services, as well as rates and tariffs for housing and utility services. This authority is determined by the terms and levels of residents' payments as percentage of housing and utility costs, established by the Resolution.

Later, Presidential Decree #221, of February 28, 1995, "On Measures for Bringing Order into State Regulation of Prices (Tariffs)" authorized the Government of the Russian Federation to determine and approve the lists of goods, works and services, prices (tariffs) which are subject to state regulation by the Government of the Russian Federation, federal bodies of executive power and bodies of executive power of the subjects of the Russian Federation. Pursuant to this Decree, the Government has approved Resolution #239 of March 7, 1995, which contains the list of goods, works and services, prices (tariffs) which are subject to state regulation by bodies of the executive power of the subjects of the Russian Federation. This list includes "payment for housing and utility services by the population", as well as "water supply and waste water services" as a separate item.

However, Federal Law #154-FZ, of August 28, 1995, "On General Principles of Organization of Local Self-Government in the Russian Federation", adopted later, established that prices and tariffs for products (services) of enterprises, agencies and organizations, which are part of the municipal property, shall be regulated by local self-governments (Article 31). Therefore, as the absolute majority of housing and utility enterprises are part of municipal property, the authority of setting rates of housing and utility payments remained primarily with local self-governments. Furthermore, the authority of local self-government to approve norms of consumption of housing and utility services, rates and tariffs for housing and utility services (except for electricity and gas) was confirmed by the Resolutions of the Russian Government #707 (Paragraph 7), of June 18, 1996, and #887 (Paragraphs 7, 8 and 9) of August 2, 1999; this authority was applied not only to

municipal enterprises and agencies, but also to housing and utility service providers with different form of ownership.

Ensuring social protection of citizens in connection with payment for housing and utility services.

Article 15 of the Law "On Foundations ..." (as amended on December 24, 1992) states that bodies of local administration provide compensations (allowances) to citizens, ensuring payment for housing within the limits of social standard of housing floor area and norms of consumption of utility services, taking into account total family income, existing benefits and approved budget. Thus, federal law indicates that assistance provided to the family for payment of housing and utility services should be based only on the amount of total family income.

Law "On Foundations ..." introduces the concept of social norm of housing floor area. The norm is the amount of floor area of housing assigned to one person, which determines the limits for housing and utilities compensations (allowances) (Article 1). Article 11 indicated that social norm of housing floor area is equivalent to the minimum size of housing provided to the citizens, which is established by bodies of within the federal level of the Russian Federation. This approach was later duplicated in a number of resolutions of the Government of the Russian Federation, regulating issues of payment for housing and utility services and provision of housing allowances.

Five years later, in 1997, Resolution of the Government of the Russian Federation #621, of May 26, 1997, "On Federal Standards of Transition to New System of Payment for Housing and Utility Services", set the federal standard for a social norm of housing floor area, which is being used for interbudgetary relations. This standard, adopted in the majority of regions of Russia, amounts to 18 square meters of general floor area of housing per one member of a family of three or more, 42 square meters - for a family of 2 persons and 33 square meters - for a person living alone.

Resolution #935 has authorized local administrations to set the share of maximum allowable household expenditures for housing and utility payments by total family income, based on the maximum level of such expenses, which was established as percentage of total family income (10 - for 1994, 15 - for 1995, 20 - for 1998). The citizens were eligible for compensation, if the amount of their expenses for housing and utility services, determined by the at residential space occupied by them (within the limits of social norm) and accounting for existing benefits, exceeded the maximum allowable share of household expenditures for housing and utility payments by total family income, set for a certain period.

The Soviet of Ministers has established compulsory compensations (allowances) only for citizens occupying residential space in municipal and communal housing. For citizens renting housing, members of cooperative housing, as well as citizens who own their housing, there was only a *possibility* of receiving such compensations. In 1999 (after adoption of Federal Law # 113-FZ, of June 17, 1999), the owners and tenants of housing got equal rights to compensations (allowances).

Federal Law #9-FZ, of January 12, 1996, has introduced an addition to the Law "On Foundations ..." changed and cardinally the principles of providing compensations (allowances) for housing and utility payments. Starting January 1, 1996, household expenses for housing and utility payments should not exceed half of minimum wage established by federal law, if the total family income per

person does not exceed the established minimum subsistence level. Thus, legislators abandoned the method of differentiating the amounts of actual payments to all allowance recipients on the basis of total family income and established a *unified* amount of payment (equal to half of minimum wage) for a considerable number of citizens.

Resolutions of the Government of the Russian Federation #707, of June 18, 1996 "On Improving the System of Payment for Housing and Utility Services" and # 887, of August 2, 1999, "On Improving the System of Payment for Housing and Utility Services and Measures for Social Protection of Population" have fixed and elaborated on both principles of allowance provision.

The second principle (basis), as mentioned above, implies that a considerable part of the population has to pay for housing and utility services *at the same price*, equal to half of minimum wage, regardless of the established rates of housing and utility payments and total family income. This equalization of the allowance amount for citizens, whose incomes may differ substantially, means elimination of the principle of providing assistance to citizens for housing and utility payments based on their total family income. Moreover, the second principle of allowance provision implies either sharp reduction (10 times or more) of the allowance amount or termination of allowance provision if the total per capita household income exceeds minimum wage by 1 Rouble. These conditions are evidence of the fact that the ways of ensuring social guarantees of citizens in the housing sector are imperfect and unfair.

Privileges for rent and utility rates.

Privileges for rent and utility rates are a legacy of the Soviet system of supporting the population. In the 1920s, local Soviets were allowed to reduce rent and utility rates paid by families with many children by 5% to 15%. However, such privileges were not universal. As well, they were recommended, but their introduction was not obligatory. Moreover, they were insignificant and could be applied only to families with many children, which were the poorest ones, as a rule. It should be pointed out that such privileges are still in effect in some cities, such as Novgorod and Vladimir.

In their current form, reduced rent and utility rates were introduced in 1975, when, on the occasion of the 30th anniversary of the victory in the Great Patriotic War, the CPSU Central Committee and the USSR Council of Ministers introduced a 50-percent reduction of rent and utility rates for disabled war veterans of the first and second groups and families of servicemen killed in action by their joint Resolution No. 304, On the Additional Privileges for Great Patriotic War Veterans and Families of Killed Servicemen, of April 18, 1975. Later, in the period between that year and 1991, several more resolutions were adopted. They provided for reduced rent and utility rates for war veterans and other similar groups of citizens, as well as for some other groups, such as specialists who lived and worked in rural areas and people working in hospitals for lepers located in rural areas.

A huge number of privileges were introduced in Russia in the post-Soviet time. During that period, privileges were provided not only for services to the fatherland to Heroes of Russia and war veterans, to families with many children, disabled people and other similar groups, but they were also provided to people of particular occupations, such as customs officers, militiamen, prosecutors, army officers, judges and others. More than ten *new* laws providing for reduction of rent and utility rates for particular groups of citizens in 1991 through 2002, and more than 30

additions were introduced in them during the same period. Moreover, the privileges provided in accordance with Soviet laws and resolutions are still in place. In many Russian cities, local laws regulating social insurance and safety net matters contain provisions taken directly from Soviet legislation or provisions that refer to them.

Thus, during the years of reform of the housing and utilities sector, the measures aimed at the reduction of municipal spending on the housing sector were implemented simultaneously with decisions that increased pressures on the federal budget. Moreover, the federal sources of finance determined by legislation can hardly compensate the budget for the provision of privileges, while financing of the implementation of the most costly law - the law on Veterans - is entrusted to governments of the subjects of the Russian Federation, which, in their term, are unable to fulfill such financial obligations.

In addition, many Russian city and regional governments have independently introduced local privileges to certain groups of citizens, such as privileges to honored citizens, participants in operations in Chechnya, single mothers, people affected by natural disasters, etc. As a result, more than 40% of Russians are now paying reduced rent and utility rates, according to the State Statistics Committee of the Russian Federation (Goskomstat).

The current system of supporting particular professional rather than social groups, alongside with the absence of a system for compensating business entities for subsidized rates, is destroying the housing and utilities sector of the Russian economy. Even if higher level budgets provide compensation for subsidized rates, the funds allotted for the purpose never reach service providers. Most often, they disappear in local budgets.

In 1996, for the first time in Russian history, Resolution of the Government of the Russian Federation No. 245 of March 6, 1996 introduced subsidized rent and utility rates for judges of the Constitutional Court of the Russian Federation and ranked members of its staff. In addition, Resolution of the Government of the Russian Federation No. 1210 of October 14, 1996 introduced the same privileges for judges of the Supreme Court of the Russian Federation and the Supreme Arbitration Court of the Russian Federation and members of their staff. The resolutions provide for full payment of rent and utilities by the above categories and compensation for such payments upon the submission of appropriate payment-confirmation documents at the place of work. In 1998, the application of these rules was extended to two more categories: judges, prosecutors and their staff members.

Such procedures for subsidizing housing-maintenance and utility services do not infringe on the rights of people entitled to privileges, but it reduces the volume of non-payments to housing-maintenance and utility enterprises. Provisions for compensation from budgets of particular organizations can be regarded as the first step taken at the federal level to initiate the provision of subsidies for housing-maintenance and utility services.

However, such procedure does not make it possible to come closer to the introduction of targeted support to those people who actually need it. It's quite obvious that poverty can hardly be attributed to particular groups of citizens entitled to reduced rates. There are poor young families, pensioners and disabled people. There are strong people in good health who are temporarily unemployed, they may be poor representatives of particular occupational groups who have many dependents in their families. That's why it is not particular professional and social groups who must be supported, but rather people of a particular family-income level.

Main directions for the improvement of federal legislation regulating payment for housing and utility services.

The bases for the federal housing policy were established by the Federal Law on the Bases of the Federal Housing Policy more than ten years ago. Though the law has been frequently amended since its adoption, it has never succeeded to make the government housing policy any more transparent, clear and consistent. During the same period, Russia's Civil Code was adopted, development of the Housing Code began and certain provisions of the existing housing legislation were amended. In addition, new problems were encountered in the process of reforming Russia's housing and utilities sector. Their resolution also requires legislative action.

All this requires that new amendments and additions be introduced into the Law on the Bases of the Federal Housing Policy. Since 1999, the Russian government has repeatedly made various amendment proposals to the State Duma. In late 2002, the State Duma passed the draft law submitted by the government in the first reading. The aim of the bill is to introduce the principles of systematic revision of rates with account taken of changes in personal incomes, introduction of targeted social support of particular families instead of the subsidizing of monopolies and balancing of the state's obligations relating to payments for housing and utilities.

The proposed bill streamlines the provisions of Articles 15, 18 and 19 of the law and introduces a number of new definitions reflecting changes in the housing and utilities sector introduced in accordance with the sub-program named the "Reform and Modernization of the Housing and Utilities Complex of the Russian Federation and implemented within the Zhilishche (Housing) Federal Purpose-Oriented Program for 2002 through 2010 (Approved by Resolution of the Russian Federation Government No. 797 of November 17, 2001). The bill also excludes the provision for the division of powers relating to regulation of payments for housing and utilities between the federal level, subjects of the Russian Federation and municipal formations. The time and procedures for the transition to a new system of payment for housing and utilities shall be established by subjects of the Russian Federation in accordance with decisions of the Government of the Russian Federation.

It should be remembered that, since the adoption of the Conception of the Reform of the Housing and Utilities Complex in the Russian Federation (Decree of the President of the Russian Federation No. 425), the Russian government has not changed its opinion about the time of introduction of non-subsidized rates of payment for housing and utilities (2003). Thus, municipal formation will get a legal right to establish housing and utility rates at a level guaranteeing complete cost recovery.

The law passed in the first reading provides for the provision of targeted housing subsidies to families depending exclusively on their income and its share used for payment for housing and utilities. The proposed version of the bill contains no provision requiring that all citizens whose average monthly income is lower than subsistence minimum in a respective subject of the Russian Federation will pay only 0.5 of the minimum monthly wage for housing-maintenance and utility services. In other words, the new law provides for the abolition of the notorious "second basis". According to the bill, the principles of the housing subsidy provision must conform to the Regulations for the Provision of Subsidies for payment for Housing and Utilities approved by the Government of the Russian Federation.

The law approved in the first reading provides for significant changes in the system of the provision of subsidies for payment for housing and utilities to particular groups of Russians.

Earlier, the Russian government asked law makers to abolish reduced rates in their current form and introduce targeted subsidies instead of them, but the proposal was not supported by law makers. According to the law passed by the State Duma in the first reading, most privileged groups will retain their current privileges and their amounts. At the same time, the law defines sources of financing such privileges (subsidized rates) more precisely: part of them must be financed from the federal budget, while the other part must be financed from budgets of subjects of the Russian Federation. Moreover, the law contains a provision allowing subjects of the Russian Federation to refuse to provide some privileges if their budgets can not afford them. This provision can come into effect only in 2005. However, its possible efficiency is already being questioned by many.

Though the new version of the law contains a number of positive improvements, the most important of which is the abolition of the "second basis" for the provision of subsidies, it is mostly a product of compromise which is unable to resolve the main problem - optimization and reduction of government obligations to subsidize housing and utility rates for different social and occupational groups accounting for 40% of Russia's population.

The reform of the system supporting the population's payments for housing and utility services is now the most important task from the viewpoint of both financial stabilization of the housing and utilities sector and social justice. The subprogram titled "Reform and modernization of the Housing and Utilities Complex of the Russian Federation" (which is part of the Zhilishche (Housing) Federal Purpose-Oriented Program for 2002 through 2010) has established that "the main idea of the economic reform in the housing and utility sector is the transfer of the right of the disposal of budgetary resources that are currently allotted to subsidize the sector from the municipal enterprises to citizens who are the persons most interested in the effective use of such funds". The same document provides for the introduction of a system of citizens' personal social security accounts. The use of such accounts will promote citizens' self-organization in the housing sector and development of the market for professional housing-maintenance service market. It will also increase the transparency of the use of funds and increase social orientation of the budgetary policy.

Experimental provision of targeted housing subsidies using citizens' personal accounts, which began in some Russian regions in 2002, was the first step towards the establishment of such a system. Given the preservation of subsidies extending to the entire population of Russia and privileges enjoyed by a significant part of Russians, it was impossible to transfer all the funds concerned to personal accounts as of the start of 2003. The experiment began after the adoption of Resolution of the Government of the Russian Federation No. 490, "On the Experimental Application of the Economic Model of the Reform of the Housing and Utilities Sector", of July 1, 2002. In the development of that resolution, Russia's State Committee for Construction (Gosstroj) developed the Procedure for the Performance of the Experiment Aimed at Targeted Social Support of the Population in the Payment for Housing and Utility Services with the Use of Personal Social Accounts and approved it on September 6, 2002.

According to the Procedure, the personal social account is construed as a bank account to which subsidies used by citizens for payment for housing and utility services are transferred. The main purpose of a citizens' personal social account is to serve as an instrument for citizens' settlements with service providers, using the budgetary funds transferred into them.

In addition to housing subsidies, other government funds intended for the housing and utilities sector may be transferred to such accounts. For instance, regional and municipal privileges can already be expressed in money terms, while respective amounts can already be transferred to

personal social accounts on the condition that citizens enjoying privileges pay for housing and utility services in accordance with the established rates. This will require amendment of Russia's local laws and regulatory documents regulating the provision of such privileges.

Conclusions

Thus, having reviewed the initial goals of the reform of payment for housing and utility services, stated in the Law "On Foundations ..." of 1992, as well as intermediate goals, described in later legislative acts and governmental resolutions, issued over the decade, we arrive at the following conclusions:

1. The goal of the housing and utility payments reform is the transition to full coverage of costs by residents' payments with simultaneous social protection of low-income families. This goal has not changed and is still being pursued by the legislative and executive authorities of the Russian Federation.
2. The terms of transition to the new system of housing and utility payments have been repeatedly moved to later dates. The legislators and the Government cannot reach a unity of opinion either on the necessity of full transition to the new system as soon as possible, or on the methods of such transition.
3. Due to the uncertainty of legislative authorities regarding the terms and stages of transition to the new system and their ultimate refusal to set the stages of transition in federal laws, the key decisions on actual terms of transition are being made at the municipal level and responsibility for these decisions falls on local self-governments.
4. The initial principle of clear and direct correlation between the social assistance provided to a family for housing and utility payments and total family income was eliminated when the second principle of allowance provision was introduced, under which the amount of allowance depends on minimum subsistence level and minimum wage. As a result, the principles of social justice in providing social assistance to the population were undermined.
5. During the years of the reform of the system of payment for housing and utilities, simultaneously with measures aimed at cancellation of subsidies to the housing and utilities sector and reduction of municipal government spending on that sector, legislative decisions were made to introduce reduced housing and utility rates to particular groups of citizens. Such decisions significantly increased pressure on the federal and municipal budgets.

3.2.2 The problem of consistency of the local and federal policies of housing and utility payments.

Over the decade from 1992 to 2002, almost all Russian municipalities have been involved in the process of reforming the system of housing and utility payments, but the process itself was full of contradictions and developed unevenly.

Over the years, the following tendency was clearly displayed: considerable increase in the share of residents' payment covering the costs of housing and utility services, decrease in budget subsidies to the sector with simultaneous provision of social assistance to low-income families with the use

of municipal budget funds. After the crisis of 1998, the actual rate of increase of the level (share) of residents' payments for housing and utility services has slowed down, and began to grow again only in 2000. Moreover, in the last two years the changes have occurred at a very fast pace.

In many regions of Russia, starting from 2000, the level of residents' payments for the cost of housing and utilities services has increased significantly. This can be explained by decreased local budget revenues in 2000 due to a redistribution of tax allocations, as well as by a strengthening of the payment discipline regarding the payments to RAO UESR. In the period from the beginning of 2000 to September 2002, the amount of housing and utility payments for a standard apartment (54 square meters per 3 persons) in administrative centers of the subjects of the Russian Federation has increased on the average 2.96 times (from RUR 251 to RUR 742 a month).

Many regions successfully implemented the program of targeted social assistance in the form of compensations (allowances) for housing and utility payments (hereinafter - housing allowance) to low-income citizens. Over 8.2% of the families with the lowest income received such allowances at the end of 2001, increasing to more than 10% in 2002, (according to Gosstroy's data).

At the same time, the progress of the reform shows that solutions, which are being implemented at the local level, very often are nothing but a distorted reflection of the federal policy. As an example, such municipal indicators as level of residents' payments for housing and utility services, prices for housing and utility services and maximum share of household expenditures for housing and utility payments by total family income do not match the federal standards.

Table 12. Data on housing and utility payments policy in some Russian cities (as of April 1, 2002)

№ №	City	Amount of Payment for Housing and Utility Services in Standard Apartment (RUR)	Amount of Payment for Housing and Utility Services in Standard Apartment as per Federal Standard of Maximum Price for Housing and Utility Services, for 2002¹⁴ (RUR)	Residents' Coverage of Housing and Utility Costs (%)	Federal Standard of Residents' Coverage of Housing and Utility Costs for 2002¹⁵ (%)	Maximum Allowable Share of Household Expenditures for Housing and Utility Payments in Total Household Income (%)	Federal Standard of Maximum Allowable Share of Household Expenditures for Housing and Utility Payments in Total Household Income for 2002¹⁶ (%)
1	Ulianovsk	460	799	52	90	18	22
2	Dimitrovgrad	531	799	70	90	20	22
3	Ioshkar Ola	516	702	67	90	20	22
4	Cheboksary	398	702	90	90	20	22
5	Vladimir	414	799	80	90	8	22
6	Kovrov	н.д.	799	100	90	16	22
7	Ryazan	529	761	60	90	16	22
8	Kaluga	746	961	80	90	20	22
9	Maloyaroslavets	н.д.	961	80	90	15	22
10	Cherepovets	837	977	100	90	10	22
11	Tihvin	н.д.	1107	72	90	19,5	22
12	Velikii Novgorod	729	1026	70	90	20	22
13	Murmansk	864	1728	50	90	17	22

¹⁴ According to Government Resolution dated November 19, 2001 # 804 "On Federal Standards of Transition to the New System of Payment for Housing and Utility Services for 2002", this federal standard is established for the subjects of the Russian Federation

¹⁵ According to Government Resolution dated November 19, 2001 # 804 "On Federal Standards of Transition to the New System of Payment for Housing and Utility Services for 2002" and the concept of reforming housing and utility sector in the Russian Federation, approved by Presidential Decree dated April 28, 1997, #425.

¹⁶ According to Government Resolution dated November 19, 2001 # 804 "On Federal Standards of Transition to the New System of Payment for Housing and Utility Services for 2002"

As indicated above, by resolutions of federal legislative power and the Government of the Russian Federation, the authority to set rates and tariffs for housing and utility services was transferred to local self-governments. At the same time, executive authorities of the majority of the subjects of the Russian Federation adopt yearly decisions on setting the level (share) of payments by the population for housing and utility services in the territory of the given Oblast, Republic or Krai. In practice, depending on the situation in the region, the share of residents' payments established by the Russian Federation serves either as the upper limit for local self-governments or as regional standard of transition to the new system of housing and utility payments. It should be noted that until recently regional standards usually were falling slightly behind the federal standards, although current interbudgetary relations encourage the authorities of the subjects of the Russian Federation to reduce this gap.

Municipalities, as a rule, are not in a hurry to increase housing and utility rates and tariffs to the level set by the subject of the Russian Federation. Moreover, municipalities, which have economic, budgetary and social conditions favorable for advanced transition to the new system of housing and utility payments, are limited by the level of residents' payment set at the regional level.

In legal terms, compliance with this level is not compulsory for municipalities. Pursuant to p.8 of Government Resolution #887, the rates and tariffs for housing and utility services (with exception of tariffs for electricity and gas) are set by bodies of local self-government. However, Subparagraph 6 of Paragraph 7 of the same Resolution recommends that state authorities of the subjects of the Russian Federation exercise control over the consistency of standards of transition to the new system of housing and utility payments in the regions to federal standards. As a result, attempts of some municipalities to "jump over" the level of residents' payments set by the subject of the Russian Federation were, at the very least, not encouraged.

A bright example of such situation is the case of Cherepovets (Vologodskaya Oblast) which is the first Russian city which made the transition to full coverage of the cost of housing and utility services by the population and the first city which has experienced the consequences of such step.

One of the reasons for the transition was the reduction of the revenue part of the city's budget and, the subsequent decrease of possibilities to subsidize the enterprises of housing and utility sector. The rates of housing and utility payments have not been raised since 1998 (when they were frozen) and real increase in the cost of services was compensated by the increase in budget subsidies. Good budget capacity allowed the city to cover the difference with budget funds. It has to be noted that budget revenues in Cherepovets in 2000 have increased considerably due to the favorable financial situation of the biggest taxpayers in the city, allowing it to increase the rates of payments for housing and utility services, while keeping the old rates for the population. Unlike many other cities, where in 2000 serious problems were revealed concerning the financing of housing and utility sector, especially energy, Cherepovets managed to avoid these difficulties. Moreover, the budget not only financed current expenses, but also repaid credit indebtedness of previous years. Nonetheless, growth of tariffs for housing and utility services combined with frozen rates of payments by the population increased the budget burden considerably. Moreover, in 2001, the budget had more modest financial capabilities due to changes in tax and budget legislation and the reduction in profit of key city enterprises (e.g. the reduction in income of OAO Severstal due to a drop in steel prices on the world market).

One of the decisive factors which enabled the city to make the decision on the transition to full payment was high level of trust of the city residents to their mayor (the present mayor of the city has been holding his position for over 8 years). The mayor was implementing reasonable socio-economic policy and possessed significant political resources which allowed him to adopt this rather unpopular decision. Before introducing full payment for services, within a year and a half,

the city administration and experts were performing a thorough analysis of the state of the housing stock and engineering infrastructure, population income, financial situation of enterprises and budget capabilities. A new, more progressive system of tariff regulation was designed and implemented.

Starting from July 2001, residents of Cherepovets have paid for housing and utility services in the amounts covering its full costs. The budget has ceased to subsidize housing and utility enterprises. The introduction of full payment in 2001 enabled the city to save RUR 400 mln., which is approximately one quarter of the city's budget. This also allowed the city to optimize budget expenses, reducing them considerably and targeting them to social assistance to low-income families, while as well increasing the volume of capital repairs of housing.

The increase in the level of residents' payment for housing and utility services was accompanied by strengthened measures of social assistance. On the basis of analysis of the level of income of the population, it was established that the share of housing and utility payments should not exceed 10% of total family income (federal standard is 22%). This means that for a considerable number of city residents with relatively low income, actual payments for housing and utility services have decreased. The number of recipients of housing allowances in the period from January to December 2001 increased from 5.3% to 19.3%, but by July 2002 the number of citizens applying for allowances had already dropped to 14%. The housing allowance office was transferred from the Department of Housing and Utility Sector to the Department of Social Policy, which made it possible to optimize and ensure regular financing of the housing allowance program.

One would think that such a step taken by local authorities in full compliance with the essence of the reform would receive full approval from regional and federal authorities. However, in reality this was not the case. This decision by the Cherepovets Mayor was met with strong opposition from authorities of all levels.

Shortly after the introduction of full payments for housing and utility services in the city, public statements made by Mr. G. Gref, the Minister of Economic Development and Trade, to the effect that the population would never pay 100% of the cost have led to the aggravation of the residents regarding the housing and utility payments policy implemented by the city administration. Not only the level of payments collection drop 30%, but there were also public protests. As a result, instead of being supported at the federal level, the Mayor was criticized from all levels as a leader who has made a hasty decision.

The Mayor became a hostage of political games, as representatives of all levels of power kept trying to gain political points by canceling the decision on the transition to full payments, and the leaders of the Ministry of Economic Development and Gosstroy discussed the inadvisability of the transition to full payment by the population for the cost of housing and utility services.

The transition to full payments by the population for the costs of housing and utility services have caused one more problem. When the tariffs for the population were increased, the volume of benefits provided to various groups of population for payment for housing and utility services also increased. Pursuant to legislation, the allowances provided should be compensated to the city from federal and regional budgets. For calculation of the allowance amounts, federal and regional standards for the level of residents' payments are used, which are 10% and 20% lower (respectively) than the level established by the city. Only 15% of the required amount (RUR 240 mln.) was allocated to the city from the federal and regional budgets. Thus, residents become hostages of a state which does not fulfill its obligations. As a result, several residents' claims were tried in court and there are endless audits, including those made by oblast officials, who claim that the debts under allowances appeared because the Mayor had introduced new rates of

housing and utility payments without sufficient budget resources for the compensation of such allowances.

As a summary, it should be noted that:

- the transition to full payment by population of the cost of housing and utility services under conditions of uncoordinated actions of federal, regional and municipal authorities has resulted in the involvement of the city Mayor, who made an unpopular decision, into political games.
- the transition to 100% payment by the population proved to be unbeneficial for regional authorities, as the expenses for the compensation of benefits provided increased
- also, the transition was not beneficial for the city itself, as, first of all, each time when the budget is planned for the next year, the share of tax allocations which remains at the city's disposal is cut, and secondly, the Mayor who made such an unpopular decision, is being criticized everywhere and his rating has dropped almost 3 times.

At the same time, the introduction of 90-percent payments for housing and utility services was planned in a number of subjects of the Russian Federation for late 2002 or early 2003. Such payments conform to federal requirements and are quite close to the cost-recovery level. The regions that planned such measures included Nizhni Novgorod, Smolensk, Irkutsk, Belgorod, Sakhalin, Kirov and others, the Krasnoyarsk and Primorsky Territories and the Republics of Chuvashia, Udmurtia and Buryatia. Moreover, from 2002 through 2003 a number of municipal formation introduced rates covering the costs of housing and utility service in full. They included the city of Kaluga, Kovrov in the Vladimir Region and Arzamas and Borrowing in the Nizhni Novgorod Region. The 90-percent coverage of housing and utilities costs is already the usual practice in tens of Russian cities. It should be pointed out that such payments are already a usual thing in many cities in Siberia and Russia's Far East, while only a year ago there were a lot of discussions about Siberia's and Far East's special way.

The gap between the "established" share of residents' payments and the one actually effective in the region reflects a lack of coordination of activities by regional and local authorities regarding the housing policy. The gap between the "established" level of residents' payments and the respective federal standard characterizes the efficiency of the federal policy in encouraging the given region to make the transition to the new system of housing and utility payments.

Slow transition of municipalities to a new system of payments is often associated with the situation when the authority for setting rates of housing and utility payments is exercised by bodies of representative power (town and raion meetings). This norm is often included Charters of municipalities. Obviously, in such a situation the housing and utility payments policy turns into a highly politicized, unpredictable and controversial issue.

As far as social assistance to the population for payment of housing and utility services is concerned, housing allowances programs implemented in many municipalities also differ from the principles declared in the Law "On Foundations ..." and in Government Resolutions.

As mentioned above, after the enactment of Government Resolution # 887 in August 1999, approval of the procedure for provision of housing allowances was no longer a matter of municipal jurisdiction alone, but became a task of both the municipality and the subject of the Russian Federation. Also, the right to establish the maximum allowable share of household expenditures for housing and utility payments by total family income was transferred to local self-governments.

The current situation leads to considerable differences between the maximum allowable share of household expenditures for housing and utility payments by total family income established locally and the federal standard. Another important difference is related to the introduction in 1996 (by addition to the Law "On Foundations ...") of the second principle of provision of housing allowance, which sets the limit for housing and utility payments for all families, whose income is below the minimum subsistence level.

Table 13. Selective data on basic principles of provision of housing allowance in Russian cities (as of April 2002)

City	Payments for housing and utility services in standard apartment per person (RUR)	Minimum subsistence level (RUR)	Maximum allowable share of household expenditures for housing and utility payments by total family income (%)	Second principle	Amount of income per person, which makes the family eligible for housing allowance under federal standard of 22% (RUR)	Estimated maximum allowable share of household expenditures for housing and utility payments based on minimum subsistence level, %
Ryazan	176	1715	16 (previously 20)	yes	800	10
Novgorod	243	1786	20	yes	1104	14
Vladimir	138	1349	8 (previously 15)	no	627	10
Nizhnii Novgorod	191	1717	18	no	868	11
Cheboksary	133	1582	20	yes	604	8
Saratov	146	1535	20	yes	663	9

For municipalities, the introduction of the second principle means a considerable increase in budget expenses for payment of housing allowances, a more difficult prognosis of the need for allowances, problems in operation of housing allowance offices, and an increased probability of receiving falsified information from families applying for allowances. The practice shows that regions and municipalities have dealt with this situation in two possible ways:

- by calculating housing allowances using the first principle only, justifying it by the absence of established regulatory methods of determining the minimum subsistence level;
- by not allocating enough funds in the budget for the provision of housing allowance based on both principles, which leads to a duplication of the situation with housing and utility benefits, when the lack of budget coverage for benefits and housing allowances results in missing revenues for housing and utility enterprises. In Russia as a whole, after Goscomstat, about 60% of housing allowances obligations are being fulfilled; however, in a number of regions only 10 - 20% of the amount of housing allowances granted to the population is transferred.

In a number of cities, decisions not to introduce the "second basis" were made together with decisions to reduce the share of citizens' expenditures on the housing and utility services (See Table 13). In such cases, all families with personal incomes below the subsistence minimum were included into the housing subsidy provision programs.

Although the second principle for the provision of housing allowances, introduced by the Law "On Foundations ...", has been in effect for 6 years already, the number of municipalities which have not introduced the provision of housing allowance based on the second principle is still rather high - about one quarter of all municipalities (e.g. Vladimir, Ryazan and others). However, the number of territories where the second principle is in effect has been growing, although slowly, from 1996 to this day. It should be noted that in these regions the percentage of families receiving housing allowance based on the first principle is reducing, while the percentage of families receiving the allowance under the second principle is growing (the family has a right to choose the most beneficial formula for calculating the allowance). For example, in the city of Omsk, given the insignificant change in the total number of recipients of housing allowances, the share of families who chose the method of calculation based on the second principle came to 13.6% in 1998, 30.8 % - in 1999, and over 70% - in 2000.

The uncertainty of legal acts concerning the issue of distribution of authority on establishing the procedure for provision of housing allowance has lead to disagreements between the subjects of the Russian Federation and municipalities. As an example, let's review the procedures for the housing allowance provisions, which are currently in effect in Belgorod Oblast and in the city of Belgorod. Under the procedure adopted by Belgorod Oblast in 2000, targeted allowances for housing and utility payments are provided "within the limits of the social norm of floor area of housing and typical standards of consumption of utility services, based on the distribution of households by income groups, total family income and existing benefits". The maximum allowable share of expenditures for housing and utility payments by total family income is set as follows: for a household with an income of up to RUR 700 per person - 10%, with an income between RUR 701 and RUR 1200 - 15%, and with an income over RUR 1201 - 22%.

Table 14. The discrepancy between the maximum admissible share of utility and housing costs in the family budget which are established at the federal level and those which are established at the levels of subjects of the Russian Federation and municipal formations (by the examples of the Belgorod Oblast and city of Belgorod)

Maximum allowable share of household expenditures for housing and utility payments established in Belgorod Oblast		Maximum allowable share of household expenditures for housing and utility payments established in the city of Belgorod (%)	Federal standard of maximum allowable share of household expenditures for housing and utility payments (%)
Average per capita income per person per month, RUR	Maximum allowable share of expenditures for housing and utility payments (%)		
up to 700	10	19	22
from 701 to 1200	15		
over 1201	22		

Thus, in Belgorod Oblast the procedure for calculating housing allowance is based on the first principle, i.e. the share of household expenditures for housing and utility payments is differentiated based on the household income. In the city of Belgorod, pursuant to municipal regulations, issued as well in 2000, but before the issue of the Oblast's regulations, housing allowances are calculated based on both the first and the second principle and the maximum allowable share of household expenditures for housing and utility payments by the total family income is in accordance with the first principle - at 19%. After the Oblast's regulations were issued, the city of Belgorod continued to provide allowances in accordance with municipal regulations.

Based on the above, we can conclude that the process of implementation of the state policy regarding payments for housing and utility services at the local level is influenced by the specifics of economic situation of every region, as well as by the local political situation and the short-term goals set by the leaders of regions and cities.

3.2.3 Hypotheses

Over the decade, after the enactment of the Law "On Foundations ..." in 1992, the reform of housing and utility payments was hindered by the inherent difficulty of finding the right balance between the goals of increasing economic efficiency of the housing sector and providing social protection to the population, as well as by external factors associated with the problems of reaching macro-economic stabilization while the progress of structural reforms remains slow.

Based on the analysis of the goals and objectives of the housing and utility payments reform, indicated by the legislative authorities and the Government of the Russian Federation, as well as on the analysis of the reform progress in different Russian municipalities, a number of hypotheses were made regarding the factors which have positive or negative impact on the rates and results of reforms in the sphere of housing and utility payments.

All the hypotheses involve the dynamics of the rates of housing and utility services. The authors are fully aware of the fact that each increase in housing and utility rates can be caused by an increase in the level of residents' payments in covering the costs of housing and utility services, as well as by increase in prices for one or another service. However, the analysis of dynamics of the level of residents' payments does not seem reasonable. The data on the level (share) of residents' payments, included in statistical form 22 -ZHKH, became available only after great delay and usually represented the level of residents' payments "declared" by local self-government, which does not correspond to the actual correlation between the rates of payments and the cost of services. On the other hand, it is virtually impossible to estimate the real share of residents' payments in covering the cost of housing and utility services, as there is no accurate information available on the full cost of housing and utility services in the cities. Therefore, in this analysis, instead of using the data on the level of residents' payments, we use the data on the rates of payments for housing and utility services in surveyed municipalities, the accuracy of which is confirmed.

Factors influencing the dynamics of the rates of payment for housing and utility services

In recent years, almost all municipalities have displayed the tendency toward increase in rates for housing and utility services. At the same time, research shows that rates of housing and utility services, set for the population at the municipal level, are being changed randomly and without any system. The most probable cause of this situation is that economic and political factors influencing the process of reforming housing and utility payments are in constant

contradiction with each other. The "freezing" of tariffs, it seems, is caused by political reasons, while decisions on raising the tariffs for housing and utility services are made under the pressure of economic factors.

On the one hand, the authorities of the subjects of the Russian Federation and of local self-government raise the tariffs and rates of housing and utility services, set for consumers, in an attempt to stop further deterioration of the housing and utility sector, which is caused by the chronic lack of financing of housing and utility enterprises accompanied by the strengthening of discipline regarding payments to energy providers. Also, the reduction in the revenue base of local budgets and their dependency on regional and federal transfers force authorities to adopt decisions on the reduction of budget allocations to the sector and, consequently, on transferring the burden of expenses for housing and utility services to the consumer. However, it should be noted that the latter factors may be viewed as political, rather than economic, as they are a result of the federal policy of strengthening the state vertically¹⁷.

On the other hand, the political situation characterized by the succession of elections to the bodies of power of different levels, including the elections of leaders of local self-government, does not provide a good environment for making serious strategic decisions; such a situation leads to the attempts to keep the amounts of housing and utilities payments at the same level for as long as possible. The majority of local leaders set only short-term political goals for themselves, which do not always correspond to the goals of long-term housing policy.

Hypothesis 1.1. *Political situation associated with elections of leaders of local self-government leads to keeping the amounts of residents' housing and utility payments at the same level.*

Factors influencing the dynamics of payments for housing and utility services by the population

Raising the residents' payments is an unpopular measure. Politicians, as well as mass media, when opposing the increase of rates of housing and utility services, argue that the population is unable to pay. Demonstrations protesting housing reform in Voronezh in 2001, despite being a specially organized political act, served to many local politicians as a good illustration of the fact that any increase of payments for housing and utility services would unavoidably have a negative response from the population. Local self-governments are also frightened by the possibility of a sharp reduction in collection of payments for housing and utility services.

However, the practice of reforming the system of housing and utility payments in a number of cities which have consistently increased the share of residents' coverage of the housing and utility costs and, consequently, the rates, shows that the reaction of the population to the local housing policy is not harshly negative.

Hypothesis 2.1. *An increase in rates for housing and utility payments does not lead to a decrease in the level of payment collection.*

Factors influencing the dynamics of the number of participants in the housing allowance program

¹⁷ The impact of these factors on the dynamics of payments for housing and utilities services was not analyzed in this report as information on these factors is too general and the data, which would allow to perform analysis with the use of statistical methods, are difficult to obtain.

Politicians and the mass media present the goal of reaching full self-sufficiency in the housing and utility sector as a refusal of the state to support the population. However, the purpose of the reform is completely different; the policy of supporting enterprises in the housing and utility sector is shifted to the population and the population only, specifically to those population group, which are really in need of support. Thus, the goals of housing and utility payments reform are formulated for achieving full payment for services by consumers with the simultaneous provision of targeted social assistance to population.

The Law "On Foundations..." of 1992 has introduced a special form of targeted social protection allowance to low-income families for payment of housing and utility services (hereinafter - housing allowances). Housing allowance is an "additional payment" which covers the difference between the amount of payments for housing and utility services (calculated based on the established rates of housing and utility payments, norms of consumption and the social norm of housing floor area) and the established maximum allowable share of household expenditures for housing and utility payments by total family income. Thus, when the rates of housing and utility payments are increased, the expenditures of households for housing and utility services also increase and consequently a larger number of households are eligible for housing allowances.

This thesis is used by politicians as an argument against raising housing and utility payments; they argue that this measure will put a heavier burden on the population and sharply increase the need for budget funds for housing allowances. The results of the implementation of the housing allowance program in many Russian municipalities demonstrate that no sudden changes were observed.

Hypothesis 3.1. *An increase in the rates of housing and utility payments does not lead to significant a increase in the number of citizens applying for housing allowances¹⁸.*

Hypothesis 3.2. *The growth in the number of housing allowance recipients is limited by social and psychological factors, and is determined by the efficiency of operation of the allowance offices.*

3.2.4. Methods of information collection and processing and evaluation of results

The analytical hypotheses on the impact of various factors on the progress of the reform of housing and utility payments are here tested on the basis of gathered statistical information, normative documents and interviews.

Information necessary for analysis was received from the following sources:

- federal legislation
- regulatory acts of Ministries and Departments
- regional and local regulatory and legal acts
- the following statistical data:
 - data of the State Statistics Committee of the Russian Federation (Goskomstat) for the period of 1997 through 2001;

¹⁸ The authors of the report realize that hypothesis 3.1. is probably self-evident and needs no proving, especially for specialists working in the housing and utilities sector and social-security workers. However, we include it in our analysis intentionally in order to verify all the political factors that affect raising of housing and utility service rates.

- data contained in state statistical survey forms 22, "Reform of the Housing and Utility Sector", compiled in the surveyed municipal formations;
- data from "elite cities" based on interviews with representatives of local authorities.

Our data was collected in ten different Russian cities with a total population ranging from 45 thousand people (Shumerlya) to 1020 thousand people (Perm). The sample included seven cities, including three regional administrative centers and three cities under the regional authorities' jurisdiction.

The information was collected in administrations of cities and oblasts, statistical committees, housing organizations, cash-settlement and information centers of housing and utility sector, housing allowance offices and social protection departments of different municipalities. In the cities, data was collected with the use of a specially designed unified analytical form, which included:

- quantitative parameters (data on budget expenses of municipalities, population of cities, population income in regions of Russia, dynamics of housing and utility rates, monthly data on billing and collection of payments from the population, data on provision of housing allowance, including number of recipients, amounts of allowances, data on the number and workload of staff of allowance offices, etc.);
- qualitative parameters (general principles of state and local policy of housing and utility payments, trends in development of political ideas at the local level, reaction of population to housing policy of local self-government, principles of provision of targeted social assistance to population for housing and utility payments, etc.).

Various methods were used in order to test the proposed analytical hypotheses, including the methods of statistical and graphical analysis, expert evaluation, the interviews with stakeholders. The methods applied and results received are described for each hypothesis.

3.2.5. Analysis results

Hypothesis 1.1.

The political situation associated with the election of leaders of local self-government leads to keeping the amounts of residents' housing and utility payments at the same level for as long as possible.

This hypothesis was tested using the results of the survey of municipal administration officials who are involved in managing the housing and utility sector. Employees of bodies of local self-government in 8 Russian cities were interviewed.

Respondents were asked five questions concerning the reform of housing and utility payments, which were worded based on the goals of the survey and the proposed hypotheses. In order to receive more accurate answers, the interviews were taken anonymously.

When answering the question, "What do you think is the main goal of the changes which are being implemented as part of the housing and utility sector reform?", 83% of respondents said that they see the goal of the reform as creating an efficient and reliable system in the housing and utility sector, ensuring the high quality of housing and utility services. However, 17% of respondents think that the whole reform was started only for the purpose of a transition to 100% coverage of housing and utility costs by the population. This indicates that not all leaders in the

housing and utility sector have a deep enough understanding of the essence of the reform, which they are supposed to implement.

The next question was about the influence of elections of leaders of local self-government on the policy of housing and utility payments in the city. Almost all respondents admitted that the process of setting the rates of housing and utility payments is more or less politicized and tied to election dates. Moreover, 60% indicated that candidates for leading positions in the cities use the stabilization or lowering of payment rates as a slogan in their election campaigns. At the same time, after being elected and accepting the responsibility for the state of the municipal economy, newly elected city leaders very often "betray" the slogans declared before the elections and raise the rates of housing and utility payments. Some examples demonstrating the degree of politicization of the process of setting housing and utility rates are given in Appendix 1.

Also, the respondents were asked about the expected reaction of the population to the actions of the administration in the event of a introduction of full payment of housing and utility costs by the population, as well as about the current opinion of the population on the policy of increasing housing and utility payments. Sixty percent of the respondents said that the full payment of housing and utilities costs by residents will cause a negative reaction among the population. At the same time, over 80% said that the population is currently against raising housing and utility payments but this does not lower the collection of payments; about 10% (one city) said that when payments are increased, collection of payments drops, and another 10% (one city) said that there were protest rallies against the increase of housing and utility payments in the city. These results will be tested when hypothesis 2.1. is analyzed.

Thus, the results of the survey of leaders and specialists in the housing and utility sector in Russian cities show that the political situation associated with local elections does not encourage bodies of local self-government to raise payments for housing and utility services. As some respondents indicated, this is most evident when the authority for setting rates and tariffs is assigned to the deputies of representative bodies, who are very reluctant to adopt such measures.

In order to test this assumption, let's compare the dates of elections to local self-government and increase in rates for housing and utility payments in several Russian cities.

It has to be noted that electricity and gas rates paid by the population are established at the level of the subjects of the Russian Federation in accordance with the recommendation of the regional energy commission. Consequently, the amount of payments for housing and utility services for a standard apartment can be increased following the decision of local, as well as regional, authorities. In this analysis we review the factors influencing the decision of local self-government.

Table 15. Comparison of dates of elections to local self-governments and increase in rates for housing and utility payments for a standard apartment ⁹, from January 1998 to March 2002 (based on the data of the Institute for Urban Economics")

City	Election date	How many months prior to election did the last increase of rates occur?	Was this the case of raising electricity or gas rates?
Cheboksary	01.2001	8	no
	12.2001	3	yes

⁹ Apartment with total floor area of 54 square meters for a family of 3

City	Election date	How many months prior to election did the last increase of rates occur?	Was this the case of raising electricity or gas rates?
Cherepovets	03.1998	More than 3	yes
	12.1999	8	no
	03.2000	4	yes
	03.2002	4	yes
Ulianovsk	12.2000	4	yes
	02.2001	2	no
Volhov	03.1998	More than 3	yes
	12.2000	5	no
Kovrov	12.2001	2	no
Orenburg	09.2000	6	no
Perm	12.2000	2	yes
Petrozavodsk	04.1998	10	no
	03.1999	3	no

It is interesting to note that, in 2001, in Ulianovsk the rates of housing and utility payments were increased by the mayor's decision two months before the elections of the deputies to the city council, but one month later, i.e. one month before the elections, the rates were lowered again.

Table 15 shows that when housing and utility rates for a standard apartment were increased without an increase of electricity and gas rates, i.e. by decision of local self-government, the increase closest in time to the election date occurred no later than 2 months before the election (Ulianovsk, Kovrov), which is the length of the election campaign, according to the law. But on the average this period lasted 6 months.

Thus, the research confirms the hypothesis that the political situation associated with local elections forces local leaders to keep the rates of housing and utility payments at the same level artificially.

Hypothesis 2.1

An increase of rates of housing and utility payments does cause a decrease in the level of payment collection.

Raising the residents' payments is an unpopular measure. Politicians, as well as the mass media, when opposing the increase of rates of housing and utility services, argue that the population is unable to pay. However, in Russia as a whole, given the general increase in tariffs and residents' share of payments in covering housing and utility costs over the past few years, no decrease in payment collection was observed. At the same time, almost everywhere in Russia, low-income families were provided with allowances for housing and utility payments. Below is some data and the results of the analysis of the system of housing and utility payments in different Russian municipalities.

Table 16. Comparison of the dynamics of housing and utility payments and the dynamics of payment collection for the period between January 1999 and June 2002 (based on the data of the Institute for Urban Economics).

City	Year	Increase in housing and utility payments in one year, %	Amount of payment for standard apartment as of the end of the year, RUR	Level of payment collection, %
Velikii Novgorod	1999	48	262,98	97,2
	2000	37	360,18	94,2
	2001	26	453,6	94,6
	2002 (June)	33	605,34	96,3
Perm	1999	25	143,52	91,8
	2000	92	276,06	91,7
	2001	75	483,66	93,1
	2002 (June)	29	624,12	89,9
Ulianovsk	1999	75	162,12	82,6
	2000	48	239,37	92,5
	2001	92	458,61	91,7
	2002 (June)	4	474,72	91,1
Cheboksary	1999	24	165,96	98,3
	2000	42	235,29	97,6
	2001	70	400,68	92,9
	2002 (June)	7	430,98	89,7
Rostov-on-Don	1999	28	406,62	92,4
	2000	15	466,87	93,1
	2001	60	745,22	99,1
	2002 (June)	26	940,68	97,2

The table data on the comparison of dynamics of the rates of housing and utility services, established for the population, and the dynamics of payments by the population in 5 Russian cities of different size enable us to draw some conclusions:

1. Given different rates for housing and utility payments in monetary terms for different cities (the amount of payment for standard apartment is between RUR 400 in Cheboksary and RUR 940 in Rostov-on-Don), the level of payment collection is approximately the same for the five cities - about 94%.
2. The Table indicates that in 1999 - 2002 the rates of housing and utility payments, established for the population, were constantly growing. In a number of cities, the growth was

considerable, with rates increasing 1.5 - 2 times. At the same time, the average annual level of payment collection for these years has been fluctuating insignificantly and is still within the range of 90 - 95%.

3. In a number of cities, given the increase in the rates of housing and utility payments, the level of payment collection not only did not drop, but even increased. This is well demonstrated by the city of Ulianovsk, where in 2000 the rates increased 1.5 times while payment collection also increased - by 10%. Next year, the rates were increased 2 times, while payment collection remained almost at the same level (92%).

Thus, the general conclusion can be made that the tendency toward raising the rates of housing and utility payments, observed in recent years in Russian cities, does not cause a significant decrease in level of payments made by the population.

In order to confirm this hypothesis, a graphical analysis of the dynamics of payment collection in 1999 - 2001 was performed. Chart 1. illustrates that the average yearly level of payments remained at the same level in 1999 - 2001 and was the same for different cities. At the same time, the Chart shows that each year the level of payment collection changed considerably from month to month: between 50% and 135%. Chart 1, reflecting the dynamics of payments collection (as a percentage of billed amounts) in five cities of the project in 2000 demonstrates the following general trends:

- the highest level of payments collection, as a whole, is observed at the end of calendar year; due to tradition, citizens who have outstanding debts for previous months try to repay them before the new year. Moreover, at the end of the year some families can receive additional income (for example, bonuses)
- a sharp reduction in level of payment collection is usually observed in January, after the new year and Christmas holidays, as well as in September – October, as during this time many families have large expenses from preparing children for school
- an increase in the level of payment collection also occurs in May and August, respectively, the beginning of the vacation season, when many citizens pay in advance, and the end of vacation season, when they pay debts.

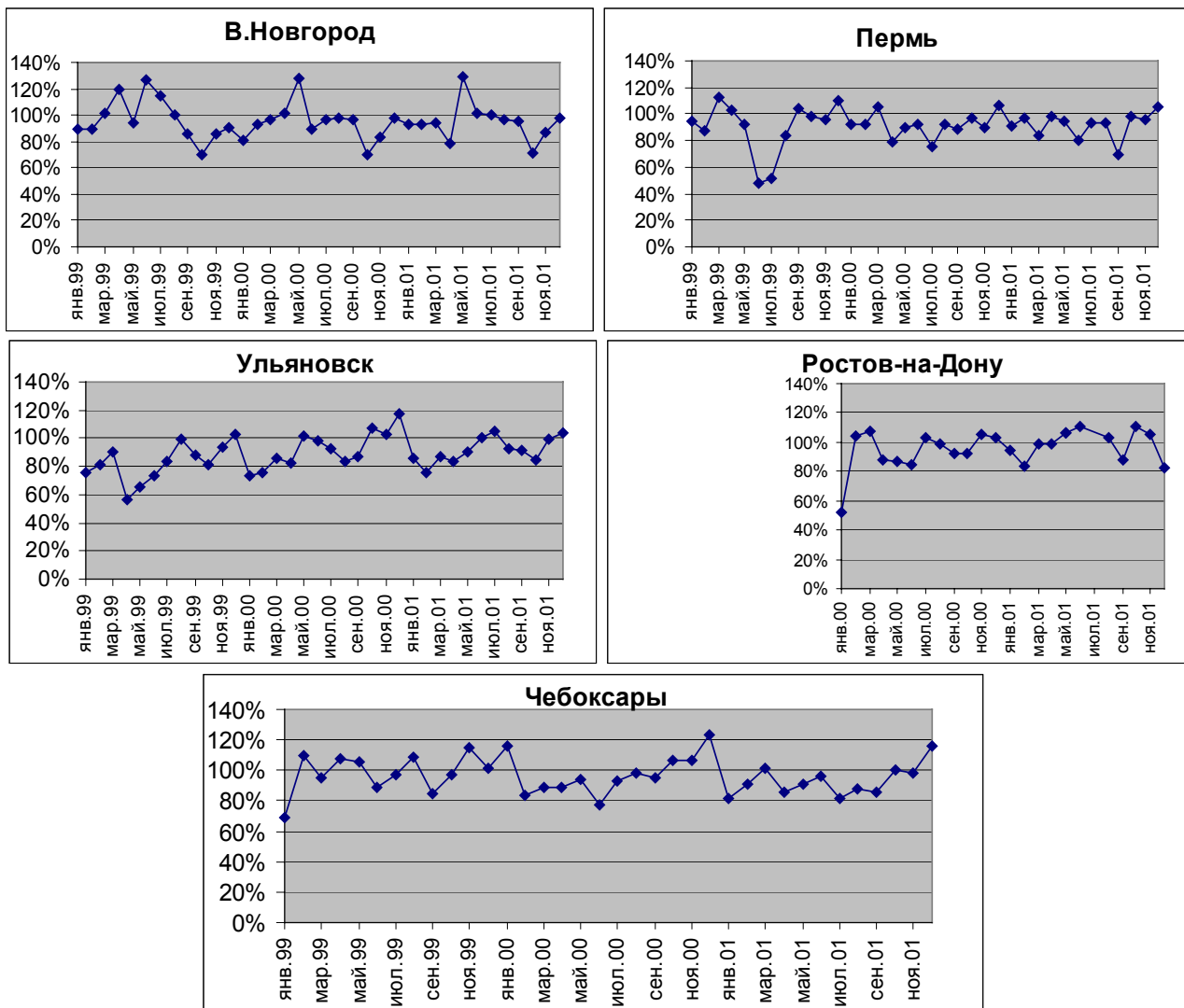


Chart 3. Dynamics of payments collection (%) in 1999-2001.

As far as the impact of tariff increase on payment collection is concerned, almost everywhere the same tendency is observed, which is especially evident in Rostov-on-Don (Chart 4.). The Chart indicates that raising the tariffs leads to a decrease in the level of payment collection for the same month. However, in the month following the month of the tariff increase the level of payment collection grows sharply, as the majority of the population not only starts to pay under the new tariff, but also repays the accumulated debt.

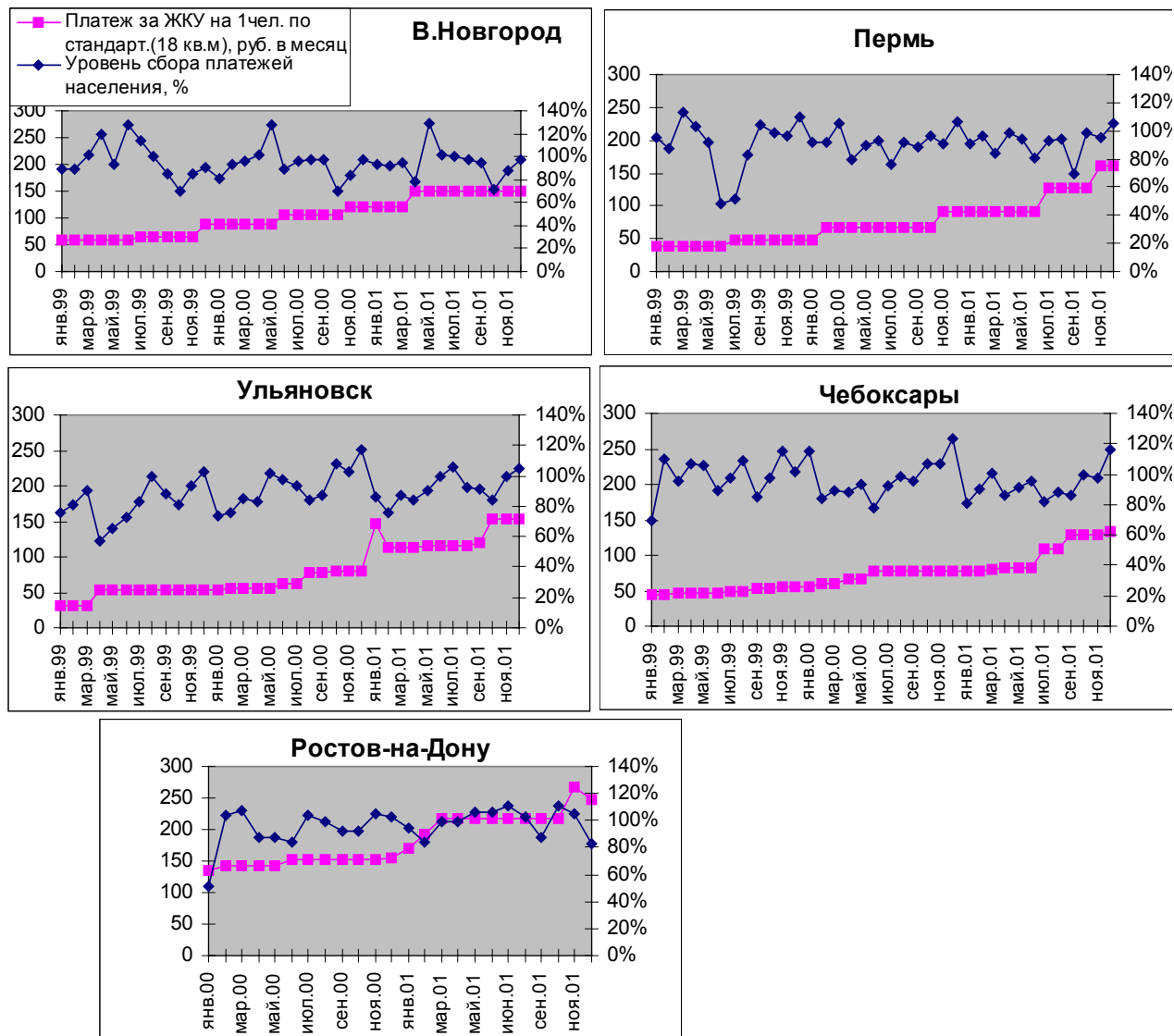


Chart 4 Comparison of dynamics of payments collection (%) and tariff growth in 1999-2001

Thus, the hypothesis that increasing the rates of housing and utility payments does not lead to a significant decrease in the level of payment collection is confirmed by the research results.

Hypothesis 3.1.

An increase in rates for housing and utility payments does not lead to a significant increase in the number of citizens applying for housing allowance.

The hypothesis was tested with the help of a graphical analysis of the dynamics of changes in the housing and utility payment rates and the number of recipients in eight Russian cities. As a whole, it should be noted that in 1999 - 2000, the dynamics of the number of program participants was highly irregular (Chart 5).

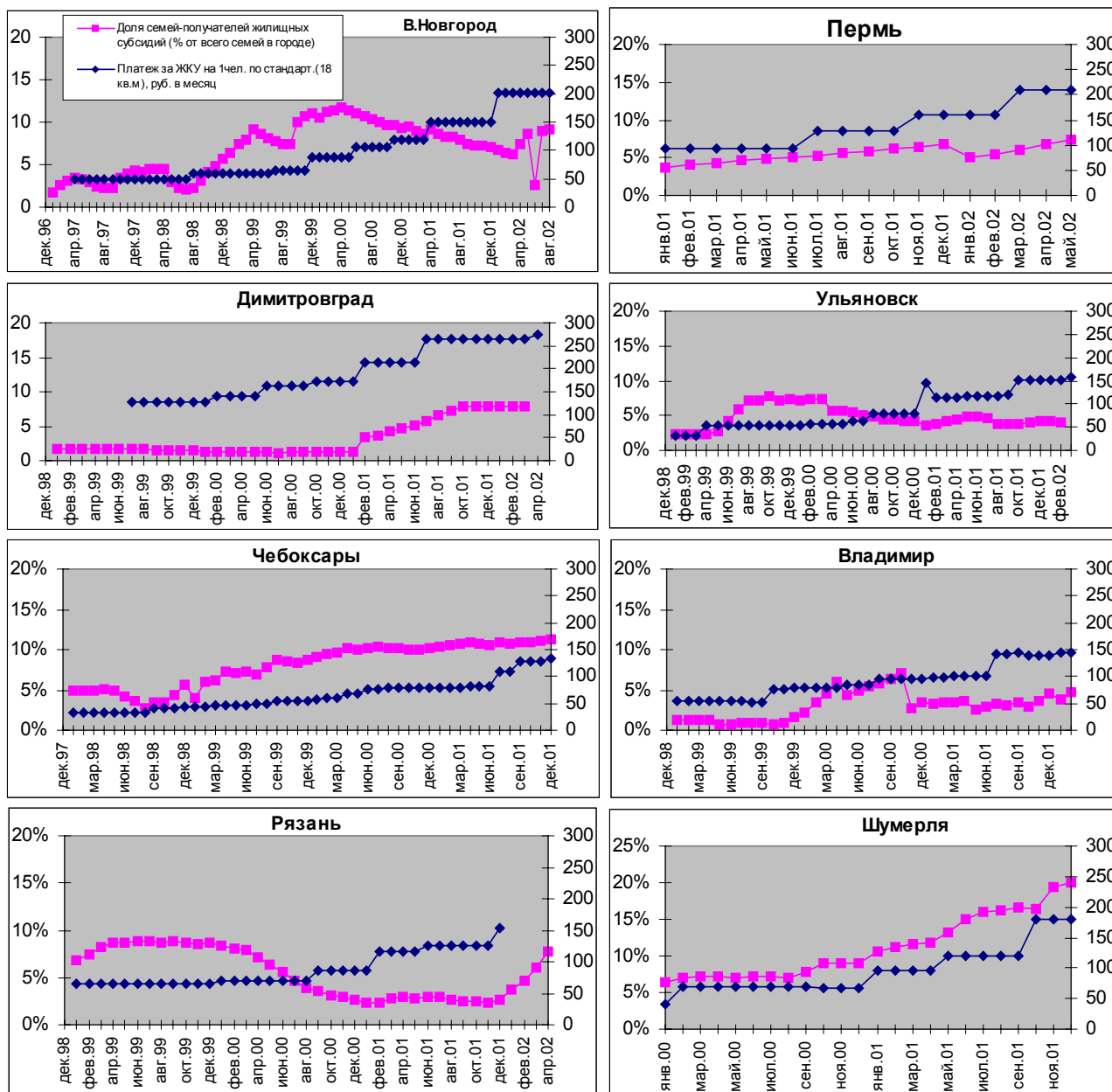


Chart 5. Comparison of the dynamics of tariff growth and share of families receiving housing allowances

In 1999, an increase in the number of housing allowance recipients was observed in many cities (Velikii Novgorod, Ulianovsk, Cheboksary, Ryazan); however, in 2000, almost everywhere, a decrease was noticeable. Possibly, the economic crisis of 1998 was one of the reasons determining the large number of allowance recipients, but the following stabilization of the economy and the growth of the population's income¹⁰ has led to a decrease in the number of recipients.

A reduction in the number of program participants in 2000 was observed even in the case of raising the rates of housing and utility payments, for example, in Ulianovsk, Velikii Novgorod, Ryazan. The main cause of this process was the growth in the population's income. The repeated increase of pensions in 2000 has resulted in almost all pensioners leaving the allowance program.

¹⁰ It can also be assumed that reduction in the number of allowance recipients was caused by increase of standard of maximum allowable share of household expenditure for housing and utility services by total family income - from 20% in 1998 to 22% in 2001. This assumption will be tested in the analysis of hypothesis 3.2.

Starting from mid-2001, simultaneously with a strengthening of the tendency toward the increase of the share of residents' payments in covering the expenses for housing and utility services, there is again some growth of the number of allowance recipients in a number of cities (Shumerlia, Perm, Dimitrovgrad, Vladimir, Ryazan). An increase in the rates of payments for housing and utility services in some cases lead to an immediate increase in the number of recipients, as it was in Dimitrovgrad and Ryazan. More often, the increase in the number of allowance recipients occurred gradually, over 3 - 6 months after increase in the rates.

Based on the graphical analysis conducted, we can make a conclusion that the increase in the level of payment for housing and utility services by the population in 1999 - 2002 did not cause a significant increase in the number of citizens receiving housing allowances. At the same time, the charts show that change (growth or reduction) in the share of families receiving housing allowance often occurs regardless of the change in the rates. Obviously, the dynamics of the number of recipients is influenced by other factors. Among them, we can name changing the principles of the housing allowance program itself (introduction or elimination of the second principle, changing the maximum allowable share of household expenditures for housing and utility payments and some others), as well as changing the level of a citizen's income. The latter factor was not analyzed due to a lack of accurate information on the income of the population in municipalities¹¹.

Hypothesis 3.2.

Growth in the number of housing allowance recipients is determined by a number of factors, among which is the changing of principles of the housing allowance program itself (introduction or elimination of the second principle, changes in maximum allowable share of household expenditures for housing and utility payments and some others), as well as efficiency in the operation of housing allowance offices.

Available data on the provision of housing allowance in several Russian cities presents a sufficient number of samples for performing a graphical, as well as regression analysis of this hypothesis. The following information was collected for the analysis:

- monthly data on the share of families receiving housing allowances in municipalities in 1998 - 2001
- information on principles of the housing allowance program in municipalities
- monthly data on the average amount of housing allowance in municipalities in 1998 - 2001
- data on the quality of work of housing allowance offices.

Information collected in six cities was analyzed: Velikii Novgorod, Cheboksary, Ulianovsk, Dimitrovgrad, Ryazan and Vladimir.

A number of quantitative and qualitative indicators were used in order to test the hypothesis, including regression with account for certain assumptions.

1. The established maximum allowable share of household expenditures for housing and utility payments by total family income. Pursuant to the Law "On the Foundations...", as amended in 1992, families are provided with housing allowances if housing and utility payments exceed the established maximum allowable share of household expenditures for housing and

¹¹ The only officially published information is the data on average per capita income on the average for the subjects of the Russian Federation. The use of such information would void the analysis of its accuracy. Collection of data on population income in municipalities presents considerable difficulties.

utility payments by total family income. This is the first principle (basis) for providing housing allowances. The federal standard for the share of household expenditures accountable to housing and utility payments, set by the Government of Russia, has been increased from 10% in 1994 to 22% in 2002. However, local self-governments are authorized to set independently the amount of this share for the calculation of allowances in the territory of municipalities, and in many cities this share is lower than the federal standard. It should be assumed that the increase in the share of maximum allowable household expenditure for housing and utility payments by total family income will lead to a reduction in the number of housing allowance recipients.

2. The absence or availability of the second principle (basis) of providing housing allowances. For citizens applying for housing allowances, it is more beneficial to receive them under the second principle, as all families whose total income is within the limits of minimum subsistence level receive the same amount of allowance, regardless of specific income data. Based on this, let's assume that when the second principle is in effect, the share of allowance recipients will increase.
3. The use of the technique of calculating total family income, taking into account family members registered in the housing. As of today, there is no unified technique for calculating total family income, which would be compulsory for all housing allowance offices. Such a technique can be approved by executive authorities of the subjects of the Russian Federation and municipalities. The Ministry of Labor of the Russian Federation recommends that this calculation be made based on the incomes of family members *occupying the housing together*. The main difficulty is presented by the issue of the proof of "joint occupancy". In practice, housing organizations bill the families for housing and utility services taking into account family members *registered* in the housing. In a few cities, there is a practice of transferring the housing and utility payments of a tenant to the apartment where he actually resides, although not registered (e.g. in Velikii Novgorod). Consequently, housing allowance offices in different municipalities can calculate total family income using, as a rule, two possible techniques based on family members actually residing in the apartment or on family members registered in it. The first option implies a more accurate calculation of total family income based on the income of all family members, regardless of registration. Application of the second option means that if a family of three occupies an apartment, but only two of them are registered, the income of the third family member will not be taken into account when the total family income is calculated. In this case, the estimated total family income will be less than the actual total family income, which improves the chances of a number of families of being included into the housing allowance program, though it lowers the level of social justice in the distribution of the means of social assistance. Thus, we may assume that the use of the calculation of the aggregate family income on the basis of the number of family members registered in a particular apartment will increase the share of families that receive housing subsidies.
4. The introduction of restrictions for participation of citizens in housing allowance program. The Law does not provide for any other grounds for denying the provision of housing allowances to a family than the sublease of the housing. However, in different municipalities, local regulatory documents or instructions of housing allowance offices have introduced some other grounds for denying the provision of housing allowances to a family. For example, there are some restrictions regarding the participation of entrepreneurs in the program, as well as participation of citizens with zero income not registered with unemployment service, citizens having outstanding debts toward housing and utility payments and others. Let's assume that the introduction of such local limitations reduces the share of allowance recipients.
5. The average amount of housing allowance. The amount of housing allowance is determined in general as the difference between the amount of payment for social norm of housing floor

area and the maximum allowable share of household expenditures for housing and utility payments by total family income. In other words, when family income increases, the amount of allowance decreases. The practice of housing allowance offices demonstrates that many families see no sense in applying for an allowance, the amount of which is small. The survey, conducted by housing allowance office in Vladimir in 2001 among low-income families who did not apply for housing allowances, revealed that the amount of time which has to be spent on undergoing all the procedures, collecting all the documents, and sometimes the transportation expenses for getting to the location of housing allowance office all "outweigh", in citizens' opinion, their desire to receive social assistance for housing and utility payments. Often the citizens evaluate the attractiveness of allowances by determining the significance of its absolute amount, without trying to establish a correlation between this amount and their income. Especially in cases when the second principle of allowance provision is being used in the municipality and many families receive allowances of the same amount, it seems quite possible to assume that the bigger the average allowance amount provided to families in the city, the more attractive the allowance program becomes to the citizens.

6. The efficiency of municipal housing allowance offices. In order to perform regression analysis, the estimated aggregate index of efficiency was used. The following indicators were taken into account when determining this index:
 - the role of housing allowance offices in the structure of municipal housing services (housing and utility sector and social assistance);
 - whether or not means testing was conducted by housing allowance offices;
 - availability and accuracy of information and databases;
 - availability and quality of computers and office equipment;
 - effectiveness of the work of dispute committees;
 - correlation between the number of in-take staff and the total number of staff in the office;
 - number of cases a day (per staff member);
 - correlation between the number of applications and the number of families participating in the program.

The above indicators were collected and evaluated for the surveyed cities. Each indicator was assigned values from 1 to 3 depending on its presence and development in a particular city. Numerical values of the indicators reflect the assumption that the higher efficiency indicators of the subsidy provision problem result in an increase in the number of the participants in the program.

Then we summed up indicator values for each city. As a result, the computed indicator could assume values between 1 and 24. As Table 7 shows, the average index amounted to 13. The highest index of efficiency of the subsidy-provision service was obtained in the city of Novgorod (16), while the lowest was in Dimitrovograd and Cheboksary (10).

3.2.5.1 Graphical analysis results.

In order to test the hypothesis, two types of analysis were performed: graphical and regression. In the course of regression analysis, the dynamics of the share of allowance recipients were compared to the dynamics of the average allowance amount and the established maximum share of household expenditures for housing and utility payments by total family income. The results (Charts 6.) did not provide a definite answer to the question (which of the factors plays the decisive role).

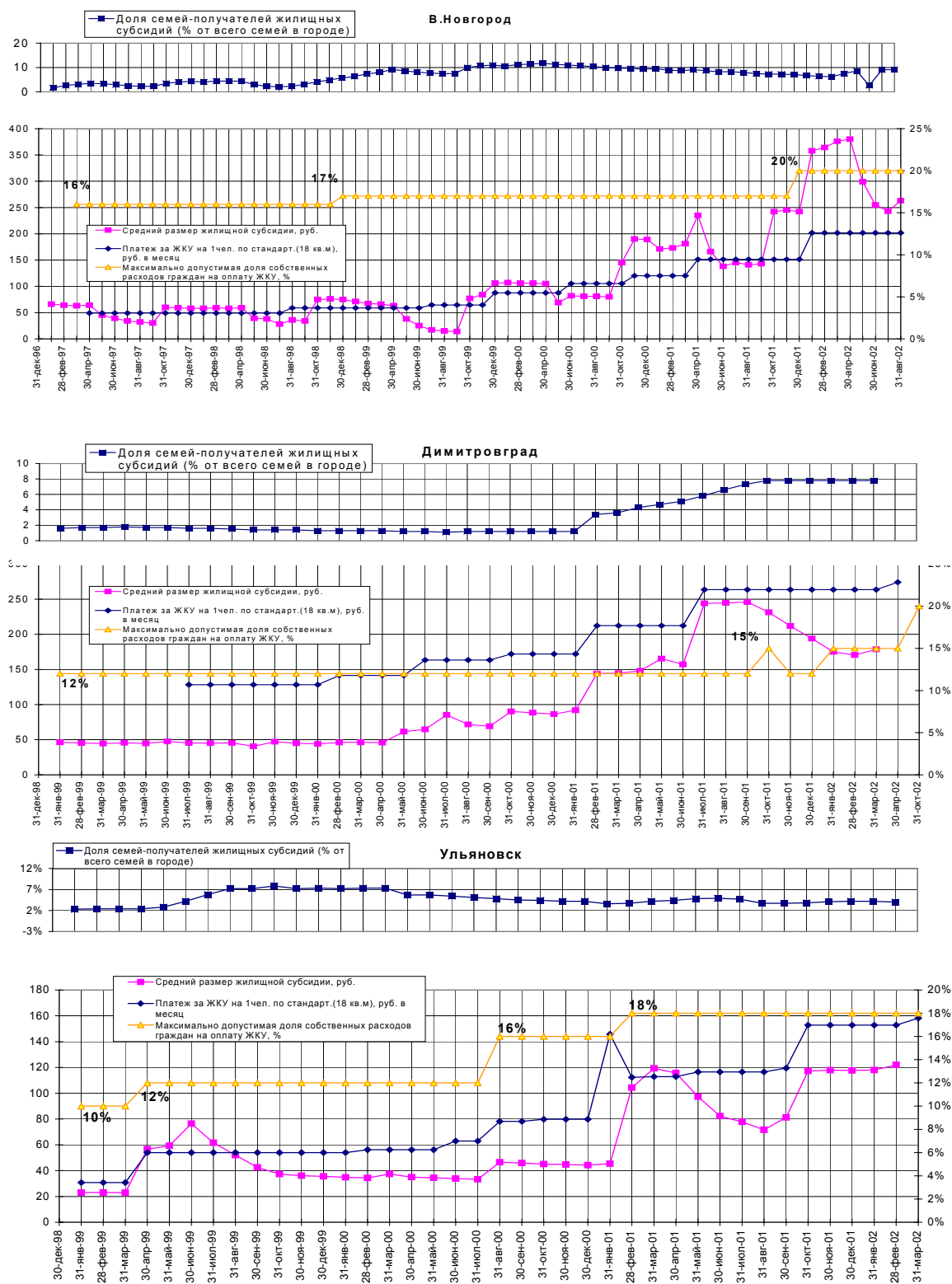


Chart 6.

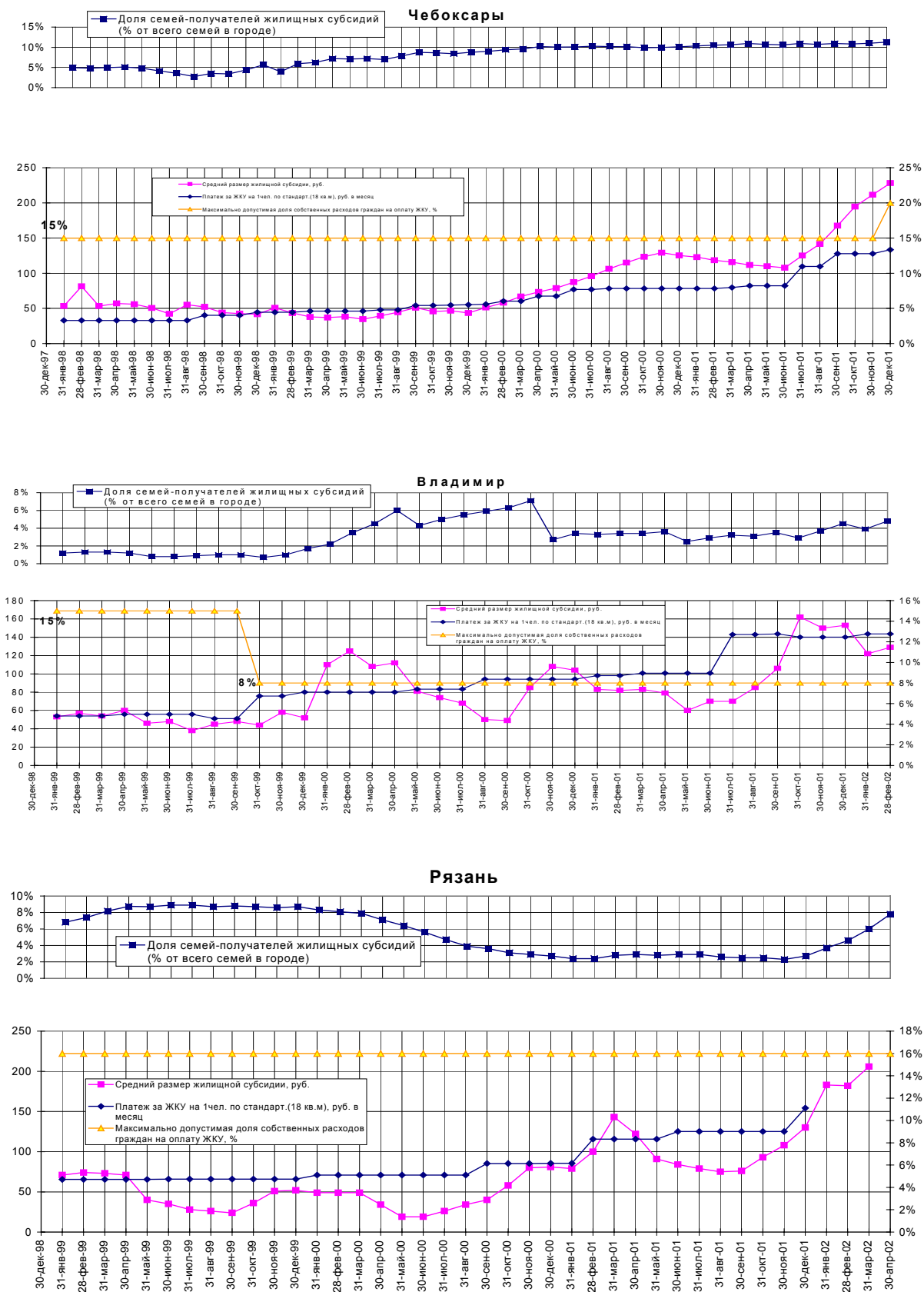


Chart 6. (continuation)

The examples of six cities, shown in Chart 6, indicate that in Vladimir and Ulianovsk the increase in the established maximum allowable share of household expenditures for housing and utility payments by total family income led to the decrease in number of allowance recipients; in Dimitrovgrad and Velikii Novgorod the number of recipients rose slightly; in Ryazan the number

of recipients decreased, while in Cheboksary it increased, although the standard of maximum allowable share of household housing and utility expenditures remained the same.

The average allowance amount differs greatly from month to month, and only in two cities are the dynamics of this indicator somewhat close to the dynamics of allowance recipients. However, the charts do not prove a clear correlation between these two variables.

In order to determine which of the factors are significant for changing the share of recipients and establish which factors are more significant and which are less significant, a regression analysis was performed.

3.2.5.2. Regression analysis results.

In order to test the hypothesis and identify the degree of influence of each of the above factors, the following regression model was used.

Table 17. Variables, employed in regression analysis.

Variable	Defenition	Mean value
SF	dependent variable; share of families receiving housing allowance	5,515
T	established maximum allowable share of household expenditures for housing and utility payments by total family income	14,5037
SB	dummy variable, showing availability (1) or absence (0) of the second principle (basis) for provision of housing allowance	0,4375
TFI	dummy variable, showing, which technique is used for calculation of total family income. If total family income is calculated based on income of all family members, regardless of their registration, the variable assumes a value of 1. If total family income is calculated based on income of family members who are registered at the given housing, the variable assumes a value of 0. It is assumed that calculation of total family income under the former technique decreases the number of allowance recipients ¹⁹	0,8235
EL	dummy variable showing availability (1) or absence (0) of local eligibility restrictions for the housing allowance program ²⁰	0,4338
A	Average amount of housing allowance, per month	102,4306
HAO	aggregate index of efficiency of operation of housing allowance offices; may vary from 1 to 24	13,1801

¹⁹ Using of the design procedure of total revenue of a family, taking into account all the members of the family regardless of registration place, reduces quantity of the families which get the allowances.

²⁰ Introduction of local limitations decreases the number of allowance recipients.

Coefficients of regression show the estimated influence of each independent variable on the amount of dependent variables, given that the factor of influence of all other variables on this variable remains unchanged. Comparison of b coefficients, corresponding to each of the independent variables, allows us to identify the most strong and weak factors (variables) determining the nature of the dynamics of the dependent variable. Regression analysis also allows us to evaluate the significance of the estimates for each coefficient.

The results of statistical analysis indicate that the independent variables, included in our hypothesis and placed into the regression equation, explain well enough the nature of the dynamics of the dependent variable. The coefficient of determination R^2 equals 0.398, which means that independent variables selected, together with the probability of about 40%, explain the nature of the dynamics of the dependent variable. The regression equation, where the dependent variable is the share of families receiving housing allowances, looks as follows.

Table 18 Regression Results

Variable	Regression coefficient
SF (const.)	-3.141
	(-2.103)
T – max. share of income	0.107
	(1.764)
SB - second basis	1.695
	(4.537)
TFI - aggregate income	-5.035
	(-5.075)
EL - local restrictions	0.416
	(0.897)
A - amount of subsidy	0.012
	(4.687)
NAO - efficiency of subsidy-provision service	0.685
	(4.344)
(Absolute t-statistics values are shown in parentheses)	
R^2	0.397
F-statistics	29.070
Durbin-Watson statistics	0.176
df (degrees of freedom)	265

In order to explain the results of regression, we have to take into account two aspects: the value of coefficients, reflecting the degree of impact of this factor on the dependent variable, and the "significance" of coefficients, as the essential significance of coefficients for the independent variable determines its influence on the dependent variable in 95% of cases in the given sample.

Coefficient b for variable T (established maximum allowable share of household expenditures for housing and utility payments by total family income) is positive. The significance test of this coefficient indicates that in 95% of observations this variable exerts a less serious influence on the behavior of dependent variables than other factors. This fact indicates that, contrary to the above mentioned assumption 1, changes in the maximum allowable share of household expenditures for housing and utility payments by total family income lead to less significant changes in the number of allowance recipients than expected.

This behavior of the variable can be explained by the fact that the regression equation also includes the factor of introduction of the second principle (basis) in the calculation of allowances, against which, as we know, the factor of the established maximum allowable share of expenditures cannot manifest itself the fullest. Thus, assumption 1 is neither confirmed, nor clearly disproved in this equation.

The b coefficient, given qualitative “dummy” variable SB (availability or absence of the second principle (basis) for provision of housing allowances) is positive, more than 1. This means that the presence of the second basis for the calculation of subsidies will lead to nearly 2% of families enrolled in the housing allowance program. Given the average value for the sample of 5.515%, this would mean a nearly 1.5-times increase. Thus, this equation confirms assumption 2. The significance test for this coefficient indicates that the influence of the availability of the second principle on the number of recipients is very significant.

Assumption 3 is completely confirmed by the value of coefficient b, given the fictitious variable TFI (indicator of the technique used for calculating total family income). The negative sign and value of the coefficient indicate that calculation of total family income based on the number of all family members, regardless of their registration, leads to the reduction of the number of allowance recipients. The significance test for this coefficient, given this variable, confirms the significance of the factor of calculation technique for determining the dynamics of the number of recipients.

As far as availability or absence of local restrictions of eligibility is concerned, it can be said that this equation neither confirms nor denies assumption 4, concerning the negative influence of this factor on the number of allowance recipients. According to the results received, coefficient b, given variable EL, is not valid. However, as in the case of the LHS factor for calculation of allowances, it can be assumed that the obvious influence of local restrictions of eligibility on the number of recipients is not reflected in this equation because of the influence of other significant factors.

The value of coefficient b under the variable A (average amount of housing allowance) is positive, and the test indicates its clear significance for the equation. This confirms assumption 5: an increase in the average amount of housing allowance leads to the increase in the number of recipients.

Finally, the positive value and obvious significance of coefficient b under the variable HAO (aggregate index of efficiency of operation of housing allowance offices) confirm assumption 6: the more effectively housing allowance offices work, the bigger the number of allowance recipients in the city. The value of this coefficient is not as high as the "second principle" and "calculation based on family members" coefficients; however, it can be said that if the efficiency of operation of the housing allowance office is increased by 1 point, about 1 more percent of families will come to the housing allowance offices.

Thus, regression analysis results justify in part our hypothesis about the influence of various factors on the share of families receiving housing allowances. Analysis of the amounts of regression coefficients shows that with the increase of the established maximum allowable share of household expenditures for housing and utility payments by total family income, the share of families receiving housing allowances should decrease sharply. However, in 95% of the cases in our sample the influence of this factor was "complicated" by the influence of other variables, the most significant of which are the availability of the second principle (basis), the use of calculation technique based on family members registered in the housing and efficiency of housing allowance offices. At the same time, the influence of such a variable as the average amount of allowance, which, in our opinion, reflects indirectly the existence of a psychological factor, is not big, though it is present in 95 cases out of 100.

3.2.6. Conclusions

Analysis of the proposed hypotheses indicates the following:

1. Although the necessity of improving the financial situation in the housing and utility sector, as well as the policy of reducing local budgets, encourage local self-governments to reduce subsidies to housing and utility sector and, correspondingly, increase the rates of housing and utility payments, there are certain factors of political nature which hinder the process of transition to the new system of housing and utility payments. The process of setting the rates for housing and utility payments is politicized and elections to local self-governments do not provide any incentives to increase housing and utility payments.
2. At the same time, the argument used by some politicians and mass media that the population is not able to pay and that collection of payments will be reduced is not confirmed by the practice. Analysis shows that the existing tendency toward increasing housing and utility payments does not lead to sharp decreases in the level of payments collection.
3. Also, analysis confirmed that increase of housing and utility payments does not play a fatal role in determining the number of low-income families eligible for housing allowances. The dynamics of the growth of the number of housing allowance recipients are determined by a sum of various factors, including - the principles (bases) of the program of allowance provision, socio-psychological factors, as well as efficiency of housing allowance offices.

3.3. Development of Competition in the Delivery of Housing and Communal Services

The development of real competitive relations is one of the key tasks of the housing and communal service sector reforms which, if resolved, will allow for increasing the service quality, curtailing unproductive costs, and boosting the attractiveness of the sector for private businesses. The economic analysis of the activities of different segments of the housing and communal services market revealed that along with realistic opportunities for the development of competitiveness in maintenance of the housing stock, there are serious technological limitations on the market for utility services (water, heat, gas, and electricity). Federal-level regulations, such as presidential decree No. 425, *On Reforming the Housing and Communal Service Sector in the Russian Federation* (with the *Concept for Reforming the Housing and Communal Service Sector in the Russian Federation*), which concerns development of competitive relations in the delivery of housing services is identified as one of the priority tasks.

This section presents an analytical overview of the formation and development of competitive relations in the management, maintenance and repair of multifamily buildings in the ownership (or, to be more exact, jurisdiction) of municipalities, as well as buildings in the departmental stock, and buildings managed by homeowners' associations. The research was intended to identify the factors which promote competitiveness in the housing sector or obstruct the development of competition. The overview covers the period from 1992 (the beginning of mass privatization of housing in the Russian Federation) to the end of 2002.

3.3.1. Legal Framework for the Development of Competition in the Housing Sector

In the period preceding the reforms the housing and communal service sector was characterized by the rigid state regulation of all housing relations and the predominance of state ownership.

The distinctive features of this system are:

- state monopoly in housing maintenance and utility services, with the loss-bearing activities of respective organizations strongly subsidized by the state;
- deep subsidizing of the initially loss-bearing operations of the housing and utility companies;
- the rights of housing owners were practically no different from the rights of tenants in the state housing stockownership rights;
- state enterprises were assigned the function of providing housing to their employees and maintaining this housing.

The preconditions for housing and communal service sector reforms were created by the law *On Ownership in the Russian Federation* <18>, which eliminated the quantity and value restrictions on the citizens' rights to own property, including residential premises. Ownership was also granted to members of housing and housing-construction cooperatives who have paid for their units in full.

Pursuant to resolution of the RF Supreme Soviet as of December 27, 1991, No. 3020-1 (<19>), some state properties were conveyed into ownership of municipalities (except cities in raion jurisdiction) and raions (except raions in cities). The properties conveyed to local governments included housing and utility facilities:

- residential and non-residential stock;
- municipal engineering infrastructure;
- enterprises engaged in the operation, maintenance, and repairs of these properties.

Since the responsibility for organizing management of the municipal housing stock has been placed within local governments. Divestiture of the state and departmental housing stock was most active in mid-90's. The share of state property in the housing and communal service sector decreased during this period from 42 to 5 percent. Additions to the municipal housing stock confronted local governments with the alternative: to create new municipal agencies for maintaining this stock or to attract private businesses on a competitive basis.

The law, *On Privatization of the Housing Stock in the Russian Federation* (<13>), permits the privatization of residential premises. Pursuant to this law, owners of privatized premises in the state or municipal housing stock are co-owners and users of internal engineering equipment and common areas in the buildings. Thus privatization of residential premises has led to a situation where one real estate object (a residential building) may have several owners who enjoy equal rights under the RF Constitution. The privatization law identified two types of properties in a multifamily residential building: residential and non-residential premises in the possession of private individuals and legal entities, and the common property. The law, *On Homeowners' Associations* (<14>), classifies common property as property serving more than one owner: stairways, landings, elevators, elevators and other shafts, corridors, roofs, crawling spaces and basements, load-bearing and non-load-bearing structures, as well as mechanical, electrical, sanitary or other equipment outside or within residential premises serving more than one unit. Individual units are managed by their owners. The common property is managed on the basis of the decisions of the general meeting of unit owners.

The law, *On Homeowners' Associations*, created the legal framework for the owners' participation in the management of the common property. It was intended to promote the transition to an object-based management of multifamily buildings and, subsequently, promote the demand for various housing maintenance services. However, the process has been very slow, and municipalities have retained their monopoly for the procurement of housing services, which is a major obstacle to the development of a competitive environment.

The regulatory framework currently in effect in Russia (see <2>, <3>, <4>, and <20> at the end of the book) envisages a three-level system of management for the multifamily stock:

- owners of the residential building;
- management company;
- contractors for the delivery of goods, works, and services required for the management function.

Using the system, it follows that competition in the housing stock is possible both for the management of multifamily buildings and for the delivery of products and services.

The formation of an economically efficient management system in the housing sector starts with the structuring of relations between property owners and management companies. The effective law permits management of the property to be organized in the following manner:

- by conveyance into economic jurisdiction;
- by conveyance into operative management;
- under a contract of trust management ;
- under a contract for the delivery of property management services for a consideration.

The right of economic jurisdiction and the right of operative management are special types of real estate rights not found in any other legal system. These rights are granted to legal entities for an undefined term and include possession, use, and disposition of the owner's property. An enterprise having economic jurisdiction over a property may possess, dispose, and use the property at its own discretion. The right to possess, use and dispose of the property conveyed

into economic jurisdiction or operative management may not be restricted by a contract and is regulated solely by the Civil Code.

The property conveyed under the right of economic jurisdiction or operative management is withdrawn from the physical possession of the conveying owner, and is placed on the balance sheet of the holder. Thus the owner may no longer exercise the rights associated with the possession and use (and, to a large extent, disposition) of the property. Importantly, enterprises holding the property under the right of economic jurisdiction are liable for their debts at the expense of this property, but do not answer for the debts incurred by the owner, because the property is treated as the “allocated property”.

The existence of legal entities which are not owners of their property but which may act as independent participants of economic transactions with it is the direct consequence of the transitional status of the economy and the heritage of the “state” economy, of which the said types of legal entities are an example.

Evidently, at the present phase the legislation adopted for the period hinders further development of an efficient system for management of the housing stock. They do not allow the owner to manage the housing stock to the extent desired by the owner, and block the development of competition in this area.

Under a contract of trust management the trustee exercises the owner’s rights with respect to the property to the extent provided for by the law or contract. The trustee has no ownership right to the property and acts in the interests of the owner (or the beneficiary indicated by the owner), though acting in his own name.

Trust management of the property may be established by any owner. The contract of trust management is a fixed-term contract and may be signed for a term not exceeding 5 years. By the general rule, upon the expiry of the contract the property should be returned to the owner.

It should be noted that the property conveyed into trust management is segregated from any other property of the conveying owner, as well as the property of the trust manager. For this purpose, the property is recorded in a special balance sheet and records. Moreover, settlements associated with the trust management of the property are made through a separate bank account.

These features make a contract of trust management preferable to contracts of economic jurisdiction or operative management. Nevertheless, this contract has several defects which limit its usefulness.

Pursuant to the Civil Code, a trust manager may be an individual entrepreneur or a for-profit company, but not a unitary enterprise. Therefore, it appears impossible to form equal conditions for the management of the housing stock by organizations of different ownership form.

The act of conveying a property into trust management should be executed in accordance with the rules for the sale/purchase of real estate. In particular, it is necessary to obtain an inventory of the property, an independent auditor’s report on the composition and value of the property and an inventory of all debts. In addition, one should bear in mind that transactions with real estate are subject to the state registration.

Also, it should be taken into account that debts under the obligations arising in connection with the trust management of the property are settled at the expense of the property, which may result in the loss of the property by its owner.

It is thus obvious that practical use of a contract of trust management faces severe difficulties which do not allow for realizing the advantages of this type of contract.

Under a contract for the delivery of services the contractor undertakes the obligation to perform specified actions in the interest of the client or a third party – beneficiary. Municipal procurement orders for the housing and communal services and contracts for management of the housing stock are characteristic examples of this type of contract.

A municipal procurement contract has several advantages as compared to economic jurisdiction or operative management, and certain advantages as compared to a contract of trust management. A municipal procurement contract enables the owner to decide at his own discretion what portion of the management activity should be assigned to the management company. Being a fixed-term contract, a municipal procurement contract can create efficiency incentives for the management company. It may be concluded with an entity of any ownership form, including municipal unitary enterprises and institutions.

At the same time, a municipal procurement contract has several defects which make it inapplicable for the delivery of housing and communal services. In accordance with the RF Budget Code <23>, a municipal procurement order is an agreement between a local government and a contractor for the performance of works (delivery of services) financed out of the local budget. Judging by this definition, one may conclude that use of the term “municipal procurement order” with respect to the housing and communal services delivered to the households is incorrect. These services are funded by two sources – the budget and the population, and the share in the cost coverage of the latter is growing steadily. It is of course possible to segregate the housing and communal services financed by the budget from the total volume of services, and to form a procurement order for this portion of the services. However, making a contract for these sums would be legally incorrect because the obligation to finance these services out of the budget arises by force of the laws and implementing acts. However, a municipal procurement order would be appropriate, for example, with respect to urban environment services, because the services are financed by the budget. Again, the delivery of housing and communal services is a different case.

One form of a service delivery contract is the so-called management contract, which is used by some cities to attract private companies to the management of the housing stock on a competitive basis.

In this contract the owner has the right to define the list of functions assigned to the management company. For example, the owner may assign the management company with the keeping of the inventory of the property, recording the property off-balance.

The contract can take into account all conditions required for the efficient performance of the management company, without restricting the initiative of the latter. A single format of the contract may be used for all housing owners, including owners (natural persons) of individual premises. The only difference may lie in the right of the management company to conclude main contracts.

The federal regulatory acts promoting competition for the housing maintenance services urge local governments to reorganize the sector by segregating the management and maintenance functions. However, the implementation of this theoretically correct approach into practice has, regrettably, failed to create a competitive environment for contracted maintenance and repair works.

Moreover, the competition for contracted services is negatively affected by the tax benefits provided for by the effective law, in accordance to which households' payments for housing services are exempted from the value-added tax (VAT). The exemption applies to payments to the management company only, while contracted services for maintenance and repairs of the housing stock are subject to VAT. Thus the tax law encourages the merger of management and maintenance functions, at the same time hindering the development of competition for contracted services. At present the entire sum of the VAT collected in a jurisdiction is transferred to the federal budget, and local administrations regard the search for legal ways of avoiding this tax as one of their main tasks. Placing the management and maintenance functions within one entity is one such way.

In light of the above, this report analyses the impact on the competition for management and maintenance of multifamily buildings of the segregation of management and maintenance

functions, and of the conveyance of the housing stock into municipal ownership with the subsequent segregation of its management and maintenance functions by the municipalities.

3.3.2. Practical Experience of Developing Competitive Relations

At present, the sphere of housing services is characterized by underdeveloped market mechanisms and lack of real competition. The predominance of administrative command and inadequate financing (first of all, from the budget) of the housing and communal service sector leave the enterprises operating in it with no incentive for reducing unproductive costs. There are many instances of municipalities collecting households' payments and using the money in violation of the intended purpose. For example, this may be done through the municipal cash and settlement centers created by the RF Government resolution No. 887, *On Improving the System of Payments for Housing and Communal Services, and Social Protection Measures*. These centers process all households' payments for housing and communal services for the purpose of their "splitting".

For all the talk about competition and opening the housing services market to private businesses, the number of municipal unitary enterprises in the sector has increased. There were 9,200 such enterprises in 1999 and over 10,000 in 2002, and the figure tends to grow. Total employees number about 2 million.

Admittedly, the policy of segregating the customer and contractor functions with the creation of customer services for the municipal housing stock has failed to produce market-oriented transformations in the management of multifamily buildings, because the activity has remained under the control of municipal bureaucrats. Even when several customer services were created in one municipality, the market was nevertheless rigidly divided between municipal administrative units. At the present time, a competition for housing management services in Russian cities is the exception rather than the rule.

The picture is better in contracted works for maintenance and repairs of multifamily buildings. The segregation of management and maintenance functions liquidated the monopoly of municipal enterprises on contracted works. As a result, private companies began to enter the market. Competitions for capital repairs contracts have become a universal phenomenon. In some cities 100 percent of capital repairs are performed by companies selected through a competitive process.

The main economic potential for the development of the property management business in residential real estate is resource-saving focused on individual buildings. To implement resource-saving, the management company should be able to use all financial resources (households' payments and budget funds) provided in payment for housing and communal services, and to make independent decisions about how, for example, to maintain the required temperature in the building (by buying the initially requested volume of heat, or by buying less but winterizing the building). There is every technological and economic reason to presume that the second option is preferable. In turn, it will lead to the gradual reorientation of current expenditures for heat supply toward capital expenditures for insulating the building, rationalization of the payment structure and, ultimately, decrease in the cost of utility services. However, the current practices in forming the municipal procurement order for utility services, according to which heat is purchased for the entire municipal housing stock, and the "splitting" of housing and utility payments at the cash and settlement centers without the participation of management companies or any contractual obligations, along with direct contracts for heat delivery between households and heating utilities create strong barriers for the development of a competitive housing management business.

3.3.3. Analytical Hypotheses

Based on the results of the analysis of the practical reform experience and the effective regulatory framework, several hypotheses were formulated about the factors affecting the development of competition in the management, maintenance, and repairs of multifamily buildings.

The key action for changing the situation in the management of multifamily buildings was the decision on housing privatization. The federal legislation was expected to give rise to the associations of homeowners for management of their properties and, as a result, to the emergence of a broad spectrum of demand for housing services and the development of competitive environment in the management of multifamily buildings.

Privatization of housing made it necessary to regard multifamily buildings as objects held by many owners. Each owner has the right to participate in the management of his property (common areas of the building), and to be informed of the management plans. It may be assumed that privatization of housing has lead to an object-based system for planning the work.

These assumptions were tested with the use of the following hypotheses:

Hypothesis 1: Housing privatization promoted associations of unit owners in multifamily buildings for management of the property.

Hypothesis 2: Housing privatization has lead to an object-based approach to the management of multifamily buildings.

Hypothesis 3: The volume of housing maintained by private companies is bigger in municipalities with a bigger number of homeowners' associations.

The normal development of competition in the management and maintenance of the housing stock needs the legislation that creates equal conditions for the economic activities of companies of all ownership forms in operating on the market for housing management services. Therefore, it is necessary to review the opportunities for the formation of competitive relations in the property management business created by the effective legislation. The civil law provides for four property management forms: operative management, economic jurisdiction, trust management and delivery of services for a consideration. It is necessary to learn whether their use promotes the development of equal competition. This assumption was tested with the use of the following hypothesis:

Hypothesis 4: The property management forms provided for by the civil law assure equal conditions for organizations of different ownership structure for the development of competitiveness in the management of multifamily buildings.

The state authorities have adopted mandatory *Rules and Norms for Technical Maintenance of the Housing Stock* (hereinafter – the Rules) <24>. The right to adopt tariffs for housing and utility services is placed with the local governments (with respect to municipal and departmental housing stock and utility services provided by municipal enterprises) and the state authorities (with respect to utility services provided by non-municipal enterprises). Compliance with the Rules involves certain costs. Establishing tariffs at a level below that required for implementing the state standards will hinder the development of the competition. In order to assess the impact of the Housing Code on the development of competitive relations in the housing sector, the following hypothesis was proposed.

Hypothesis 5: Competition for housing management services is more intense in municipalities where compliance with the Housing Code is secured by the appropriate financing.

The incidence of competitions for management and maintenance of the housing stock was selected as an indicator for characterizing the development of competitiveness in this area. The influence of various factors on a municipality's decision to hold a competition was studied. The following hypothesis was proposed:

Hypothesis 6: The likelihood of a housing management or maintenance competition is higher in municipalities if:

- **total floor space of multifamily buildings exceeds 2 million square meters;**
- **management companies have the form of a municipal unitary enterprise or the functions are performed by private companies;**
- **housing management and maintenance functions are assigned to different organizations;**
- **the competition is initiated by the local government (local government issues the administrative decision to conduct the competition); and**
- **management companies comply with the Rules.**

Data Collection Method Used for the Analytical Overview

Factors affecting the development of competitive relations in the management and maintenance of the housing stock in the cities of the Russian Federation were studied with the use of the following data sources:

- federal, regional, and local regulations;
- Goskomstat of Russia, data from 1997 to 2001;
- Local statistics (Form 22 ZKH – *Reform*);
- Data provided by municipal administrations and administrations of the Federation Subjects;
- Sociological surveys.

Source data was collected from municipal administrations, administrations of the Federation Subjects, statistical authorities, and enterprises. In order to identify significant factors for the formation of competitive relations in the housing sector and calculate statistical regularities in their development, the data were collected with the use of a special unified questionnaire, designed to support subsequent analysis of:

- quantitative parameters:
 - number of private companies engaged in maintenance of the housing stock;
 - number of competitions held for housing maintenance services;
 - number of competitions held for capital repairs of the housing stock;
 - number of competitions held for special types of work;
 - percentage of the multifamily stock maintained by competitively selected companies;
 - percentage of capital repairs performed on a competitive basis;
 - percentage of the multifamily stock maintained by non-municipal companies;
 - percentage of capital repairs of the housing stock performed by non-municipal companies;

- level of payables and receivables of the enterprises selected through competitive procedures;
- qualitative parameters:
 - availability of contractual relations:
 - correspondence of the cash flows and contractual obligations;
 - assessment of the performance of the maintenance company by:
 - housing management company;
 - city administration;
 - population;
 - assessment of capital repairs by:
 - housing management company;
 - city/raion administration.

The identification of factors affecting the competitive environment for housing management and maintenance services necessitated the analysis of:

- financial indicators:
 - cost and inventory of the services which are put up for the competition;
 - correspondence of actual financing and the level declared at the competition;
 - correspondence of the cost of services and actual financing;
- organizational structure of the sector in each particular city:
 - segregation of the housing management and maintenance functions;
 - organizational legal form of housing management companies;
 - participation of the city administration in the conduct of the competitions;
- compliance of municipal regulations to the new economic conditions created by the housing sector reforms, from the viewpoint of:
 - availability of contracts;
 - availability of formal procedures for conducting the housing maintenance competitions, the quality of these procedures, and other factors.

Respective data was summarized in a table that was used as a basis for identifying patterns in the formation of contractual relations in the management and maintenance of the housing stock. After a preliminary analysis and verification of the data collected, a sample was formed from the data for 25 municipalities in the Russian Federation for the period from 1997 to 2002. The municipalities differ in size, ranging from cities with over 1 million residents, such as Nizhny Novgorod, to small communities, such as Bikinsky raion (Khabarovsk krai) with a population of 35 thousand. The municipalities also differ by the extent to which they have developed contractual relations. On the one hand, the sample includes Bor raion (Nizhny Novgorod), where competitions have been held for more than 5 years, and on the other – the city of Ulyanovsk where not a single competition have been held. The municipalities surveyed are listed in Table 19.

Table 19. Municipalities in the Survey

Municipality	Federation Subject	Population, '000	Competitions held in 1997- 2001?
Bikinsky raion	Khabarovsk krai	35.0	No
Bor raion	Nizhny Novgorod oblast	63.3	Yes
Buzuluk	Orenburg oblast	86.7	No
Veliki Nobgorod	Novgorod oblast	229.5	Yes
Vladimir	Vladimir oblast	337.1	Yes
Volkhov	Leningrad oblast	50.4	Yes
Gatchina	Leningrad oblast	81.8	No
Gatchina raion	Leningrad oblast	114.4	No
Gus-Khrustalny	Vladimir oblast	73.4	Yes
Dimitrovograd	Ulyanovsk oblast	137	No
Yoshkar-Ola	Republic Marij-El	249.2	No
Luga	Leningrad oblast	40.5	No
Magadan	Magadan oblast	156.4	No
Nizhny Novgorod	Nizhny Novgorod oblast	1,357	Yes
Novocherkassk	Postov oblast	184.4	Yes
Orenburgh	Orenburg oblast	523.6	Yes
Lazo district	Khabarovsk krai	60.0	No
Perm	Perm oblast	1,009.7	Yes
Petrozavodsk	Republic of Karelia	282.1	Yes
Ryazan	Ryazan oblast	529.9	Yes
Ulyanovsk	Ulyanovsk oblast	667.4	No
Khabarovsk	Khabarovsk krai	600.5	Yes
Tsyvilk	Chuvash Republic	11.3	No
Cheboksary	Chuvash Republic	459.2	Yes
Cherepovets	Vologda oblast	324.4	Yes

3.3.4. Results of the Analysis

The tests conducted with respect to the proposed hypotheses revealed that neither an active demand nor an active supply of the management and maintenance services has developed in the past decade. Market relations have failed to reach their full force, as a natural environment for their development has not been put in place.

The results of the tests are described below.

Hypothesis 1: Housing privatization promoted associations of unit owners in multifamily buildings for management of the property.

The research has shown that privatization of residential premises failed to generate activity and interest among the unit owners in managing the property, and, as a result, did not promote the development of competition for housing management services.

The criteria for determining the property management activity of residential and non-residential owners was the number of various owner associations in multifamily buildings. In most of the municipalities surveyed the number of multifamily buildings managed by an owners' association did not exceed 1 percent. Even in cities which have achieved the greatest success in the formation of homeowners' associations the share of multifamily buildings managed by these associations does not exceed 10 percent (Cheboksary – 7.5 percent, Rostov-on-Don – 8 percent, Volgograd – 10 percent).

The appearance of homeowners' associations has failed to initiate the private property management business or competition on the market for these services. This is most probably explained by the low share of multifamily buildings with such associations. A greater portion of the currently existing associations perform the management and maintenance functions with the use of their own resources. In the cities covered by this survey their share exceeds 98 percent. Only a few associations outsource management services, typically to municipal management companies.

The lack of activity in managing the common property among owners of residential and non-residential premises is explained by the following reasons:

- As proved by the reform experience, it is impossible in a small period of time to change the behavior of the residents who have acquired ownership of their homes for free. The many decades of the state monopoly in this field have taught people that management of a multifamily building is the obligation of the public authorities. This is why residents who have actually become owners of the building are unwilling to participate in its management and demand a qualified service from the authorities for what is essentially a private property.
- The inadequate budget compensation for the difference in the tariff rates for communal services, and for the benefits and allowances granted to the households, the unavailability of a real system of contractual relations in the housing and communal service sector, along with the impossibility for private owners to influence the allocation of budget funds for the sector create economic barriers for the formation of homeowners' associations.

The artificially supported monopoly of municipal unitary enterprises or municipal institutions in the management of multifamily buildings forces the newly created homeowners' associations to manage their buildings independently, which is not always reasonable from the economic point of view, or to hire municipal organizations. Naturally, the lack of real demand for the housing services among private owners results in the lack of supply and competition.

Hypothesis 2 – Housing privatization has lead to an object-based approach to the management of multifamily buildings – was not confirmed.

In all municipalities surveyed the local regulatory framework does not require object-based management or openness of the planning process to the public. Moreover, the regulations often require management to be organized for the entire territory of the municipality (Vladimir, Veliki Novgorod, Yuzhno-Sakhalinsk), equalize owners' payments or promote redistribution of payments among buildings. The lack of object-based planning makes it difficult for home owners to participate in the management of their buildings, reduces management efficiency and obstructs the development of competition for management services.

Hypothesis 3 – The volume of housing maintained by private companies is bigger in municipalities with a bigger number of homeowners’ associations – was formally confirmed.

The result was expected as 98 percent of homeowners’ associations manage their buildings independently. However, the statistical reliability of this conclusion is low because of the small share of buildings where such associations have been created. Moreover, the dangerous orientation of the homeowners’ associations toward use of their own management resources does not support the task of improving the quality of housing services or of forming a competitive market for these services.

Hypothesis 4 – The property management forms provided for by the civil law assure equal conditions for organizations of different ownership structure for the development of competitiveness in the management of multifamily buildings – was proved wrong.

In all the cities surveyed, except Petrozavodsk, municipal housing stock, including privatized units, is in the economic jurisdiction of municipal enterprises or in the operative management of municipal institutions. The case of Petrozavodsk is exceptional in that a substantial portion of the housing stock is managed by a private company under a contract for paid services – a contract for management of the municipal housing stock.

A competitive environment presumes equal conditions for accessing the market for all participants. By the beginning of reforms, providers of management services to multifamily buildings were represented by state and municipal organizations. The civil law (RF Civil Code) made specific provisions for these organizations concerning the form of management of state or municipal property, the right of economic jurisdiction and the right of operative management. These special forms are inapplicable to either non-state or non-municipal entities.

Fig. 13. The legal form of management companies in the cities surveyed

Fig. 14. Relationship between the incidence of competitions and the legal form of the management company

The rights of economic jurisdiction and operative management do not provide for the possibility of making a contract between an owner and a party authorized by the owner. The owner cannot dispose of or manage the property. The property held by right of economic jurisdiction or operative management may not be alienated or reallocated without the liquidation or reorganization of the enterprise or institution. Thus, the right of economic jurisdiction and the right of operative management assign management of the property to municipal organizations for an indefinite term. Early in the reform process, the majority of multifamily buildings were conveyed to municipal organizations under the right of economic jurisdiction or operative management. In this manner municipal authorities solidified the monopoly of municipal organization for the management of multifamily buildings. The special operating conditions for the state and municipal organizations hinder the development of competition for management services.

However, a competitive environment cannot take form in the absence of equal conditions for organizations of different ownership form. This is the core reason for the lack of competition in the management of the housing stock. No such competitions were held in the 25 cities surveyed, with the exception of Petrozavodsk. As of the end of 2002, competitions for management of the municipal housing stock were held in two cities, Moscow and Petrozavodsk

The final phase of the competition for a contract for management of the municipal housing stock took place in Petrozavodsk on October 30, 2001. A single lot was offered, containing housing in several districts of the city with the totals area of 1,244 thousand square meters. The four bidders

included the municipal Customer Service, which managed all municipal housing stock (4,200 thousand square meters), and three organizations, which at that time provided maintenance of the housing stock, *OOO Trial*, and municipal housing enterprises.

Trial was named the winner. The company maintained the housing stock of 300 thousand square meters in the district that was put up for the competition. Therefore, the company provided combined management/maintenance services to one portion of the housing stock, and management services only to another.

Before it could hold the competition, the city administration had to address some property issues. At that time the municipal housing stock was held in the operative management and on the balance sheet of the Customer Service. The administration had no right to assign management of the stock to another organization, should that organization win the competition.

Thus prior to the competition the city administration, with the consent of the Customer Service, withdrew the municipal housing stock from the operative management of the latter and transferred it to the municipal treasury.

The City Department for Housing and Communal Services and *Trial* signed a three-year housing management contract company. The contract established quality parameters for the management of residential and non-residential facilities, rights, obligations, and for the liability of the management company and the city administration.

Trial concluded contracts for maintenance services to the housing stock. The contracts are structured in accordance with the principle of “volume of work matches the volume of money”. As a result, *Trial* has no debts to contractors or its employees. The city heating utility and *Trial* made a contract to which the city administration is a third party with the responsibility for financing the budget component of the heating tariff (subsidies, allowances, and benefits). Thus the management company can operate in a relatively stable environment, bearing responsibility only for the timely collection of households’ payments for the heat in the maximum volume possible.

While the time that has elapsed since the signing of the contract with *Trial* in Petrozavodsk is too short for making final conclusions on the company’s performance, the very fact of a private company entering the market for housing management services should be regarded as a major step in the development of competition for these services.

Hypothesis 5: Competition for housing management services is more intense in municipalities where compliance with the Housing Code is secured by the appropriate financing.

In 80 percent of the municipalities surveyed, competitions for contracted works attracted municipal enterprises only. The interviews conducted in the course of the survey revealed that the unwillingness of private companies to enter the competition was caused by the vague definition of the list of works in the draft contract and the perceived impossibility to ensure compliance with all requirements of the Housing Code at the proposed tariff rates. At the same time, local governments are not ready, for formal reason, to order work in accordance with the actual financing available.

The obvious conclusion is that establishing tariffs for the housing services below the level required for compliance with the Housing Code obstructs the development of competitive relations in the housing sector. At the same time, the statistical data available present unambiguous evidence that the Housing Code plays far from a key role in the determination of the cost of housing services. In this context, let us consider the legal aspects of the issue.

Fig. 15. Compliance of the management companies with the Housing Code in the cities surveyed

Fig. 16. Relationship between the incidence of competitions and compliance with the Housing Code by the management company

In 1997 Gosstroj of Russia issued an order approving the Rules and Norms for Technical Maintenance of the Housing Stock <2I>. According to the information published in the bulletin of the RF Ministry of Justice No. 2, 198, this document was denied registration with the ministry. Therefore, the Rules are not binding and have the nature of recommendations.

The Gosstroj order and the new Rules were designated to supersede the earlier Rules and Norms for Technical maintenance of the Housing Stock approved as far back as 1989 by the order of RSFSR Minzhilkomkhos. The denial of the registration means that the “old” Rules and Norms for Technical Maintenance of the Housing Stock remain in effect and are binding on the public authorities. The evidence is provided by a great number of successful court suits against non-compliance with this regulatory document. The contracts for maintenance of the municipal housing stock originated by local governments contain contractor’s obligations to comply with the effective Rules and Norms for Technical Maintenance of the Housing Stock. However, the tariffs for housing services are set with regard to the actual budget capacity of municipalities and the paying capacity of the households, rather than the requirements of the effective law. As a result, actual financing does not match the contracted works, the volume of maintenance works decreases, and the buildings deteriorate and become accident-prone. Under the pressure of the local administrations, municipal entities are forced to agree to such conditions, while private companies prefer not to enter agreements that they will be unable to respect. This is the reason why competitions often attract municipal enterprises only or are declared unconstitutional.

The competitions were the most participated for capital repairs of the housing stock. In 6 out of the 25 cities surveyed – Cheboksary, Orenburg, Veliki Novgorod, Nizhny Novgorod, Petrozavodsk, and Perm – capital repairs are contracted exclusively on a competitive basis. In 5 cities the competition for capital repairs attracted over 15 bidders represented by companies of different ownership structure. The high activity of private companies on the market for capital repairs is explained by the fact that the volume of capital repairs usually matches the volume of financing.

Many cities finance capital repairs of the housing stock at the expense of the budget only. Under this arrangement, local governments are obligated to perform respective works within the framework of municipal procurement orders, for which, according to the effective legislation, competitive placement is mandatory.

Hypothesis 6: The likelihood of a housing management or maintenance competition is higher in municipalities if:

- **total floor space of multifamily buildings exceeds 2 million square meters;**
- **management companies have the form of a municipal unitary enterprise or the functions are performed by private companies;**
- **housing management and maintenance functions are assigned to different organizations;**
- **the competition is initiated by the local government (local government issues the administrative decision to conduct the competition); and**
- **management companies comply with the Rules.**

The impact of various factors on the likelihood of a housing management or maintenance competition being conducted in municipalities was investigated with the use of SPSS for Windows 10.0, which, among other things, allows for the correlation and regression analyses of the source data.

The correlation analysis methods were used to determine the links between all pairs of factors characterizing the development of competition in the management and maintenance of the housing stock. The factors most closely connected to the likelihood of a competition were identified, as well as factors most closely connected with one another within the framework of the initial sample.²¹

Selected results of the correlation analysis are presented in Table 20.

²¹ In accordance to the requirements to a regression model, a dependent indicator should be described by conditionally independent variables. In this connection, the regression model describing, say, the influence of certain factors on the likelihood of competitions, cannot use such factors as the area of the municipal housing stock and the population of the municipality, because these factors are closely related to each other.

Table 20. Correlation²² of the Factors Characterizing Competition for Housing Management and Maintenance Services

Factor	Link	Number of Observations	Coefficient of Correlation
Number of management and maintenance competitions	Area of the housing stock put up for the competition	120	0.890
	Area of the municipal housing stock put up for the competition	120	0.905
	Area of the housing stock conveyed to private companies as a result of the competition	114	0.941
	Area of the housing stock managed by homeowners' associations	120	0.782
	Area of the municipal housing stock put up for the competition as a percentage of the total stock	67	0.763
	Number of municipal enterprises – participants of the competition	120	0.994
	Total number of bidders	120	0.997
	The ratio of the initial competition price and the established maintenance tariff for the households	64	0.436
	Population of the municipality	77	0.538
The incidence of a competition in the current year	Area of the housing stock in the municipality	120	0.339
	Compliance with the Rules and Norms for Technical Maintenance of the Housing Stock by the management company	120	0.331
	Legal form of the management company	120	0.248
	Segregation of the management and maintenance functions	120	0.489
	Housing of homeowners' associations as a percentage of the total housing stock	120	0.331
	The “political will” (decision of the local government about holding the competition)	120	0.887
	The ratio of the initial competition price and the established maintenance tariff for enterprises	64	0.701

²² The data presented here include only significant links (the coefficient of correlation > 0.7) of high reliability.

The correlation analysis has established fairly close links²³ between the number of competitions for maintenance of the housing stock and the area of the housing stock put up for the competition (coefficient of correlation – 0.881). The results of the correlation analysis were used to build a regression model for testing the initial hypotheses.

At first, 6 linear regressions were built with the dependent factor being the likelihood of a competition and one independent variable for each of the factors mentioned above.

Because the variable is dichotomic (i.e., may have one of the two values), the one-factor regression models for the likelihood of a competition were built with the use of binary logistic regression.

As a result it was learned that if the effect of the above factors are counted separately, the greatest impact on the likelihood of a competition is produced by the availability of the administrative decision to conduct a competition (Nadelkerke R-factor = 0.886), while all other factors have little effect on the likelihood of a competition. The factors are listed above in the order of diminishing importance:

- segregation of the management and maintenance factors (R-factor = 0.290);
- area of the municipal housing stock (0.188);
- compliance with the Rules (0.140);
- form of the management company (0.084).

This method, however, is unable to determine how the likelihood of competitions will be affected by the combined force of all these factors. The answer to this question can be provided by a multifactor analysis, which was also performed with the use of the binary logistic regression.

The initial model contained the following variables:

CL – a dependent variable describing the likelihood of a competition. The variable equals 1 when the competition is held, and 0 in all other instances.

HS – a categorical variable describing the area of the municipal housing stock (0 – less than 2 million square meters; 1 – over 2 million square meters).

F – a dichotomic fictitious variable characterizing the form of the management company (0 – municipal unitary enterprise, 1 – municipal institution).

S – a dichotomic fictitious variable characterizing the segregation of the management and maintenance functions (0 – functions not segregated, 1 – functions segregated).

PW – a dichotomic fictitious variable characterizing the political will of the local government on the issue of competitions (0 – no, 1 – yes).

A test of the model on the basis of the data available showed that the model allows for a fairly accurate forecast of the likelihood of a competition being held (121 cases out of 125) with the high level of statistical reliability. However, the significance of most of the variables in the model turned out to be low. Therefore, it follows that, on the one hand, the model contains variables which predetermine the incidence of a housing maintenance competition, and on the other – that the model contains variables which do not affect the likelihood of a competition.

A step-by-step exclusion of insignificant variables (see Table 21) has produced only one independent variable characterizing the “political will” of the local government on the issue of holding a competition.

²³ The link is regarded as close if the module of the coefficient of correlation exceeds 0.7 and the reliability level does not exceed 0,005.

The reduction in the number of variables did not affect the statistical reliability of the model, and the new model allowed for a correct forecast of the likelihood of competitions in the same 121 out of 125 cases, while the significance of the remaining factors fully complied with the established criteria.

Table 21. Models Used to Determine the Factors Affecting the >Likelihood of a Competition

Mark	Variable	Variants	Variant 1 (one independent variable – PW)		Variant 2 (PW – political will – factor excluded)		Variant 3		Variant 4
			Initial model	Final model	Initial model	Final model	Initial model	Final model	Initial model
CL	Likelihood of a competition	0 –no 1 -yes							
R	Compliance with the Rules	0 – no	1.574		1.861	1.871	2.072	2.202	1.871
		1 – yes	<i>0.298</i>		<i>0.008</i>	<i>0.006</i>	<i>0.001</i>	<i>0</i>	<i>0.006</i>
F	Form of the management company	0 – MUP	-0.958		-0.983		0.42		
		1 –MU	<i>0.544</i>		<i>0.127</i>		<i>0.352</i>		
S	Segregation of management and maintenance functions	0 – no	0.661		2.648	2.073			2.073
		1 –yes	<i>0.671</i>		<i>0</i>	<i>0</i>			<i>0</i>
HS	Area of the housing stock	0 – under 2 mln.sq.m.	0.863		2.319	2.156	2.104	2.198	2.156
		1 – over 2 mln.sq.m.	<i>0.863</i>		<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>
PW	Political will	0 – no	13.691	7.008					
		1 -yes	<i>0.747</i>	<i>0</i>					
Constant			-4.049	-4.369	-3.539	-3.574	-2.666	--2.564	-3.574
			0.001	0	0	0	0	0	0
R-factor (Cox and Snell)			0.651	0.641	0.369	0.356	0.253	0.247	0.356
R-factor (Nadelkerke)			0.899	0.886	0.51	0.492	0.349	0.342	0.492
Doubled negative value of the logarithm			29.362	32.795	103.329	105.925	124.528	125.39	105.925

Note: The values of B-coefficient are printed in **bold**, the values of t-statistics are in *italic*.

The analysis of the resulting model shows a direct dependence between the likelihood of a competition and the decision of the local government. In 42 cases out of 43 (97.7 percent) a competition for maintenance of the housing stock was held as a result of pertinent decision of the local government. The one exception was a city where no formal document was in place, but an oral order was given to organize the competition. At the same time, in 79 cases out of 83 (96.3 percent) a competition was not held for lack of the appropriate administrative decision. Out of the total number of observations, in 63.2 percent of cases the unavailability of such a decision resulted in the absence of competitions, in 2.4 percent of cases the decision failed to result in a competition, in 33.6 percent of cases the political will with respect to this issue resulted in a competition being held, while in 0.8 percent of cases a competition was organized without the interference of the local administration.

These results indicate that the main condition for the formation of competitive relations in the housing sector is the political will, rather than economic reasons. This conclusion is well illustrated by the following example. In the light of the concept for the housing and communal service sector reforms, a local administration as the owner of the municipal housing stock must select a management company, which, in turn, will either select contractors, or do the job with the use of its own resources. In reality the local authorities interfere with the activities of the housing companies and demand competitions to be held for contracted services. Appropriate regulations are issued for this purpose.

An administrative decision has the determining role in the organization of competitions for the management, maintenance and repairs of the housing stock. However, in the 25 municipalities surveyed, in the course of 5 years (1997-2001) competitions were held in only 14 municipalities and three municipalities have conducted only one competition.

Fig. 17. Relationship between the incidence of competitions and the availability of pertinent decision of the local self-government

Worthy of note is that, competitions often decreased the cost of services. The percentage of municipalities where the cost of works put up for the competition was reduced as a result of the competition is given in Fig. 18.

Fig. 18. Percentage of municipalities where the cost of works put up for the competition was reduced as a result of the competition

Taking into account that the availability of political will largely determined the likelihood of competitions, all other factors turned out to be insignificant. In order to understand the actual impact of these factors, new models, from which the political will factors were initially excluded, were built (see variant 2). In this case the initial regression model included the following variables:

CL – a dependent variable describing the likelihood of a competition. The variable equals 1 when the competition is held, and 0 in all other instances.

HS – a categorical variable describing the area of the municipal housing stock (0 – less than 2 million square meters; 1 – over 2 million square meters).

F – a dichotomous fictitious variable characterizing the form of the management company (0 – municipal unitary enterprise, 1 – municipal institution).

S – a dichotomous fictitious variable characterizing the segregation of the management and maintenance functions (0 – functions not segregated, 1 – functions segregated).

A test of the model on the basis of the data available showed that the model allows for a fairly accurate forecast of the likelihood of a competition being held (105 cases out of 125) with the acceptable level of statistical reliability (Hedelkerke R-square = 0.510). Only one of the factors (the form of the management company) turned out to be insignificant and was excluded from the final model.

The elimination of the factor accounting for the form of the management company had practically no effect on the statistical reliability of the model (the Hedelkerke R-square reduced to 0.492, and the χ -square decreased by 2.596), and the new model correctly predicted the fact of a competition in the same 105 cases out of 125, while the significance of the remaining factors fully complied with the established criteria.

In the new model, the key factor determining the likelihood of a competition for maintenance or repairs of the housing stock is the segregation of the management and maintenance functions. As a rule, the segregation of these functions did not lead to the development of competition for the housing management services, but fairly often promoted competition for the maintenance services. It should be noted here that while the correlation analysis did not show any statistical dependence of the **PW** (political will) and **S** (segregation of the management and maintenance functions) factors, the dependence is nevertheless there, because competitions for contracted maintenance services were initiated by the local authorities, rather than by the management companies.

In big, medium-sized, and selected small municipalities; the segregation of functions has stimulated competitions for maintenance of the housing stock, special works, and capital repairs. In small municipalities the segregation of management and maintenance functions resulted in the monopolization of housing management in 70 percent of cases, and, as a rule, did not promote competition in the maintenance services. (The one exception is Bor.)

Fig. 19. Availability of the segregation of management and maintenance functions in the cities surveyed

It should be noted that the administrative segregation of the management and maintenance functions does not always lead to competition in the maintenance and repair services for the housing stock. Small municipalities will find it more reasonable to demonopolize management, rather than segregate management and maintenance. According to the economic analysis, the minimization of unit costs under combined management and maintenance functions may be achieved for a housing stock of about 200 thousand square meters of total floor space. Therefore, the combination of these functions will make it possible to form several housing management companies within the boundaries of the municipality.

Fig. 20. Relationship between the incidence of competitions and the segregation of management and maintenance functions

The size of the city turned out to be an important factor. The bigger the city, the greater the likelihood of competitions being held. Small municipalities hold competitions less often than medium and big ones, as demonstrated by Figs. 21 and 22.

Fig. 21. Percentage of municipalities holding competitions, depending on the size of the municipality

Fig. 22. The likelihood of holding a competition in relation to the total area of the municipal housing stock

The organizational legal form of the management company has little impact on the competitiveness of the environment. In the municipalities surveyed management companies have the form of a municipal institution or a municipal unitary enterprise (with the exception of Petrozavodsk, as noted above). This factor does not affect the likelihood of competitions. At the same time, the number of competitions actually held is a little bigger if the management company is a municipal institution. The insignificant difference may be explained by the strict administrative interference of the city authorities in the activities of housing management companies regardless of their legal form. The civil law provides for the economic autonomy of municipal unitary enterprises which, unlike municipal institutions, are commercial entities. However, in reality municipal administrations interfere with the economic activities of municipal unitary enterprises demanding unfunded services and use administrative levers to cause the competitions to be organized dictating the size of the gap between the starting price and the final price of contracted services, resulting in enterprises being unable to realize the financial benefits of the competitions. Thus both the unitary enterprises and institutions in municipalities see the competitions as the result of the administrative influence of the local government, rather than an economic need. The dependence of competitions on the segregation of the functions and the form of the management company is shown in Fig. 23.

Fig. 23. The dependence of competitions on the combined influence of all factors (segregation of functions, form of the management company)

On the whole, 62.8 percent of the competitions were held by management companies established in the form of a municipal institution, and 37.2 percent of the competitions were organized by municipal unitary enterprises.

3.3.5. Analysis of the Survey of Officials and Specialists of the Housing and Communal Service Complex in Different Municipalities

A survey conducted within the framework of this research targeted heads and specialist of the housing and communal service departments of the local governments in different municipalities, and directors of municipal housing and utility enterprises to reveal the extent of their understanding of the goals and purposes of the sector reforms, and to identify local factors which hinder the development of competition for housing services.

Based on the purpose of the research and the hypotheses proposed, 12 survey questions were formulated about such issues as reform priorities, contractual relations in the provision of housing and utility services, competitions for maintenance and repairs contracts, and the adequacy of the municipal regulatory framework in view of the new economic conditions in the sector.

The survey was held in 20 cities in Russia among 76 respondents, who included: 5 vice-mayors responsible for the sector, 3 oblast administrators, 13 heads of departments and committees for the housing and communal service sector, 18 leading specialists of departments and committees for the housing and communal service sector, 16 directors of sector enterprises, and 21 medium-level managers. The survey was conducted through personal interviews with IUE experts and by electronic means. Some questionnaires were filled out in a phone conversation or mailed by post. Data on the number of respondents in each city is given in Table 21.

Table 21. Respondents and Cities

City	Respondents	
	Administration officer	Employee of sector enterprise
Bor	1	2
Buzuluk	2	4
Veliki Novgorod	1	
Vladimir	2	
Volkhov	1	1
Rostov-on-Don	2	
Dimitrovograd	2	2
Yoshkar-Ola	2	2
Moscow	3	6
Nizhny Novgorod	2	3
Novocherkassk	1	
Orenburg	3	2
Perm	3	1
Petrozavodsk	2	3
Ryazan	1	
St. Petersburg	2	3
Ulyanovsk	3	4
Cheboksary	2	2
Cherepovets	1	1
Yuzhno-Sakhalinsk	3	2
Total	39	37

About 32 percent of the respondents identified the main goal of the housing and communal service sector reforms as the formation of an efficient socially-oriented system which ensures the appropriate quality of the housing and communal services and the development of competitiveness; 27 percent of the respondents stated the goal of increasing the reliability of the sector and of the entire life-supporting system by strengthening state support; 23 percent of the respondents saw the goal of the reforms as the timely provision of high-quality services for adequate pay; and 17 percent voiced the opinion that the only purpose of the reforms was the transition to a 100-percent coverage of the service costs by the households. Thus more than one half of the respondents defined the reform goals as increasing the efficiency and reliability of the system for the purpose of improving the quality of the housing and communal services.

Speaking about specific reform areas in the cities, 22 percent of the respondents wanted to reform “everything”, 34 percent proposed to “start with the management of the sector, including mechanisms for tariff-setting and budget finance”, 25 percent spoke for the transformation of

contractual relations in the sector, and 18 percent stressed the importance of reforming communal heat and water systems.

As regards factors which hinder the development of competitive relations in the sector and the improvement of the quality of housing services, 47 percent of the respondents see the key problem as **imperfect legislation at the regional and municipal levels**, believing that federal laws alone are insufficient; 19 percent stated that quality requirements should be demanded and observed and subject to a 100-percent coverage of the service costs and named **inadequate budget financing** as a negative factor; 17 percent noted the close links between the weak contractual relations and **lack of political will among the local governments**; and 15 percent believed that **“the heart of the matter lies in poor management”**.

The attraction of private companies to the delivery of housing services was supported by 89 percent of the respondents, and only 11 percent “do not find it necessary”. In answering the question about which organizations— private or municipal – work better, 49 percent preferred private companies; 15 percent named big municipal multifunctional companies; 21 percent believed that “the ownership form does not affect the quality of the work”; and 14 percent were of the opinion that judgments should be made on an individual basis depending on the management quality of the organization and its financial status.

The main factor for the development of competitive relations in the management and maintenance of the housing stock, stated by 70 percent of the respondents, is **municipal competitions for maintenance and repairs of the existing housing stock**. However, 18 percent of the respondents stressed that “competitions are effective only if all participants are treated equally and there are clearly defined ‘rules of the game’”, and 12 percent were convinced that competitions were not essential for promoting competitiveness.

In answering the question about the effect of contractual relations on the quality of housing and communal services, 83 percent of the respondents spoke for “a clear system of contractual relations which provides a basis for the development of competition and, as such, promotes better service quality, because it allows for efficient use of economic mechanisms – as opposed to administrative methods – for fulfilling the contractual obligations to quality standards and timeliness of the services. Seventeen percent of the respondents were convinced that the system of contractual relations could function properly only subject to normal financing, a condition which the majority of Russian cities are unable to satisfy.

Out of the 76 percent of respondents 51 percent supported contracting for maintenance and utility services through a management company, arguing that “it is more convenient for the population, and it is easier to enforce the quality and timeliness of service provision”; 32 percent argued that “in the current situation it is preferable for the municipalities to use direct contracts for utility services between the households and resources providers”, naming as one reason the confusion of balance records for in-building nets; 17 percent stated that contracts for service delivery to the households should have line committee or department of the local government as one of the parties.

On the whole, the survey has confirmed the main analytical hypotheses. It has also revealed the dissatisfaction of respondents with the progress of reforms. The respondents were almost unanimous about the need for enacting “good regulatory and legal documents, which would work under the new economic conditions” at all legislative levels in order to ensure normal operations of the sector enterprises. The “good” documents named by the respondents included broad program documents determining the development of the sector at the local level, ‘normal’ transparent budgets with funds for the housing and communal service sector appropriated as a separate budget line”, as well as applied documents regulating quality standards for the housing and communal services, and regulations for organizing efficient energy-saving and metering of power and water resources.

3.3.6. Conclusions to Section 3.3

The comparison of the results of the survey and the statistical data on the qualitative parameters of the development of competition in municipalities, which were collected in the course of analytical research, allows for a number of general conclusions:

1. The privatization of residential premises failed to generate activity and interest among the unit owners in managing the property, and, as a result, did not promote the development of competition for housing management services. The enactment of appropriate laws at the federal level did not lead to the expected mass creation of homeowners associations for addressing the property management issues. Consequently, no developments occurred in the demand for a broader range of housing services. This has negatively affected the formation of a competitive environment in the management of multifamily buildings.
2. The competition for housing management services is obstructed by the special conditions created by the effective civil law for state and municipal organizations based on the right of economic jurisdiction and the right of operative management.
3. A serious obstacle to the development of competition for housing maintenance services is the lack of coordination between the tariffs for housing and communal services, actual budget capacity and population incomes.
4. In most of the cities which have provided data for this analysis there is little competition for housing maintenance services, but a much better situation is observed for contracted capital repairs of the housing stock.
5. The development of competition for housing management and maintenance services depends on the political will of the local governments. While understanding the importance and need for holding housing management and maintenance competitions and the practical benefits of such competitions, local governments do not hold them for the stated reasons of defects in the legislation, lack of budget funds, and increase in the cost of work by the amount of VAT levied on contracted works.
6. The defects of the current legislation for the regulation of relations in the housing sphere prevent the formation of preconditions for the development of competition in the housing sector and create no incentives for the attraction of private businesses.

3.4. Development of Associations Of Homeowners

3.4.1. Overview of legal pre-requisites for the Establishment and Activities of Condominium associations

One of the objectives of the housing and real estate policy proclaimed by the RF government in the early 90-ies of the XXth century was to transfer the management of the major bulk of the housing stock including multifamily buildings to private homeowners.

As a result of free privatization of housing initiated by the federal Privatization Law (*On Privatization of Housing in the Russian Federation*, #1541-1, issued on 07/04/91), the structure of the housing stock in the Russian Federation has crucially changed. To date, private homeowners occupy 64 percent of the housing stock, 40 percent of which are units in multifamily buildings.

The massive home privatization in Russia has given rise to a situation when practically all multifamily buildings in the country are now occupied by more than one or even many homeowners. The ownership in housing implies the free right of an owner to manage his own property. That is, to make decisions on its maintenance, repair and use. Moreover, the RF Civil Code provides property owners not only with the right but also with the burden of maintaining the property (Art. 210, *Burden of Maintaining Property*). Therefore, today the housing sector reform is expected not just to boost the privatization process in the sector but also help private owners become real managers of their property.

However, today in Russia, as in the early 90-ies, most of the multifamily stock is still managed by municipalities. The unwillingness of residents to become participants of the housing policy making process as well as to assume responsibility for maintenance and management of the property they live in is rather favorable for municipalities, which continue to ignore the right of homeowners to participate in the common property management. As well, they continue to use administrative mechanisms of economic management, to hold a monopoly on delivery of utility, property maintenance and renovation services, and to impede the creation of necessary economic and administrative preconditions for the expansion of other models of property management. In an attempt to instigate the involvement of private homeowners in the property management from above the federal government issued a law welcoming the creation of associations of homeowners as a new model of property management.

Condominium as a single property complex.

The Housing Policy Fundamentals law issued by the RF government on December 24, 1992 (*On Fundamentals of the Federal Housing Policy*, #4218-1, hereinafter referred to as the Fundamentals Law) stipulates that unit owners in multifamily buildings are considered co-owners of common elements in their buildings. That is, “elements designed to service more than one homeowner including staircases and hallways; elevators, elevator and other wells; corridors, roofs, attics and basements; fencing, bearing and non-bearing structures, mechanical, electric, sanitary and other equipment installed outside or inside a building and servicing more than one units; adjacent land plots within the established boundaries including landscaping elements and improvements located on them; as well as other objects designated to serve a single real property complex” (Art. 8). The Fundamentals law was the first in the Russian law to use the term “condominium”. The 1997 edition of the law interpreted this term as a single complex of real property including units and common elements. The law also specified that common property in a condominium is held in the shared ownership of the homeowners, and cannot be alienated from their ownership (Art. 8, It. 2). These provisions were later fixed in the RF Civil Code (Article 29,

It. 1 and 2)²⁴, and the Homeowners' Associations Law, (*On Associations of Homeowners*, # 72-FZ, issued on 06/15/96, Articles 1 and 7).

The Homeowners' Associations Law (hereinafter referred to as the HA Law) gives an extended definition of the term "condominium": a real property complex including a land plot within the established boundaries and a building and other property objects located on it, some elements of which (units) are used for accommodation or other purposes and belong to homeowners, and some elements (common elements) of which are used as common property in a shared ownership by the homeowners" (Article 1).

Today, most difficulties in condominium registration are encountered when it is necessary to define the legal status of condominium land. The HA Law (Articles 1, 5, 8) treats condominium land as a common property of homeowners, and states that a person buying an apartment in a multifamily building simultaneously acquires a share in the common elements and land belonging to a condominium. Later, the provisions of the HA Law on land rights of condominium members were confirmed by the Presidential decree # 485 (*On Guarantying the Right of Property Owners to Acquire Ownership to Land under their Property*, issued on 05/16/97) and the RF Government resolution #1223 (*On Approval of Regulations for Establishing the Size and Boundaries of Condominium Land Plots*, issued on 09/26/97).

However, neither the HA Law, nor other legislative statutes issued have clear provisions obliging local governments to treat condominium land plots as common property of homeowners, no matter whether there is or is not a registered association of them. Until 2001 this vagueness of the law was widely used by local land administrators as a ground not to recognize the homeowners' right to hold condominium land in ownership, which was in fact contrary to the HA Law provisions. However, the situation did not change in favor of homeowners' associations even after the adoption of the Land Code. Russian cities set about to develop State Cadaster formation procedures, but most programs neither took into account the interests of both existing and future condominium associations nor aimed at the formation of condominiums as unified property complexes.

Achievement of homeowners' consensus on condominium management

Unit owners in multifamily buildings have to use housing and utility services collectively. Therefore, in multifamily buildings, where residential and non-residential elements belong to multiple owners, a consensus of all homeowners on the terms and methods of the property management is required.

The Fundamentals Law in its 1992 version made no difference between the terms "condominium" and "association of homeowners" thus making the registration of an association of homeowners as the only possible way of management of property that could be held in common share ownership. In particular, the Law stipulated that, "construction, maintenance and renovation of multifamily houses, apartments and other residential units constituting a condominium should be regulated by contracts (concluded between homeowners)" (Article 8). (other than the registration of an association of home (unit) owners), the RF Civil Code (Part I, Article 291 issued in 1994) also failed to suggest homeowners mechanisms for reconciling their interests in order "to ensure the exploitation of a multiapartment building, the use of the apartments and their common property"..

The HA Law was the first that proclaimed the right of homeowners in multifamily buildings to create associations by their free will, and suggested several property management models for the

²⁴ Unlike the Fundamentals Law, the Civil Code (Art. 290) does not treat adjacent land plots as a property held in common share ownership of unit owners.

management of condominium property. Under this law, condominium homeowners are eligible to decide themselves which of the suggested models suits them best. The law (Articles 20 and 21) suggests three property management models:

- 1) direct management of the property by all homeowners - for condominiums having no more than four units and a limited (from two to four) number of homeowners;
- 2) delegation of the responsibility to manage the condominium property to a state or a municipal property management company;
- 3) registration of an association of homeowners that may either manage the condominium property itself or delegate this responsibility to a contracted property manager.

In view of the enactment of the HA Law, Article 8 of the Fundamentals Law was corrected in 1997 to read: “homeowners ... *may* form an association of homeowners”. With this correction, the formation of homeowners’ associations (HOA) is no longer treated as the only way for reaching a consensus between homeowners on their property management.

Still, notwithstanding provisions according to which homeowners are considered eligible rather than obliged to choose a property management model, the HA Law at the same time requires that a fine be imposed on those who fail to do that within six months (Article 20). This penalty can be applied only to condominiums where more than 50 percent of units are held in private ownership. Still, the Law fails to specify who and how should apply this sanction in practice²⁵, and in addition local governments have no practice of monitoring changes in the rate of owner-occupied units in multifamily buildings. Consequently, it is hardly possible to cite at least one case of imposing this penalty in practice.

For a better understanding of how unit owners in condominiums may come to a property management consensus, it is important to understand how the law regulates the problem of condominium membership. Under the HA Law (Articles 32 and 49), the membership in an association of homeowners was obligatory for all unit owners. In 1998, the RF Constitutional Court declared this requirement contradictory to the RF Constitution²⁶ thus permitting homeowners to stay apart of an association of homeowners and thus not to participate in the collective management of their common property. Practically, the RF Constitutional Court recognizes the prevalence of a private freedom of choice over joint interests of other homeowners. However, the collective mode of consumption of housing and utility services in multifamily buildings makes it impossible to leave a particular homeowner without them. So, by refusing to participate in the joint management of the property a homeowner, in fact, infringes on rights and interests of other homeowners in the building.

Worth noting is the fact that Russia is the single country in the world that legalize this prevalence. Obligatory registration of homeowners’ associations in multifamily buildings is a legitimate practice in many countries including Norway, Denmark, Germany, Netherlands, Switzerland, Poland, Hungary, Czech Republic, Kazakhstan and Uzbekistan. In Slovakia, Romania, Bulgaria< Estonia, Latvia, Lithuania, Belarus and Moldova associations are created on a voluntary basis. But all countries are common in requiring the obligatory membership of all homeowners in an association as soon as it is created in a particular building except Russia.

Encouragement of HOA formation.

The effective law suggests a series of incentives intended to create “a favorable environment” for the formation and operation of associations of homeowners. Yet in 1992, the Fundamentals Law

²⁵ Until July 2002, this was the responsibility of the State Housing Inspection, but on 12/30/01 it was repealed by the federal law #196-FZ.

²⁶ Decree of the RF Constitutional Court #10-P as of 04/03/98.

stipulated that the main advantage of HOAs was an opportunity “to control costs and service prices and select maintenance and renovation service providers”.

The HA Law also permits HOAs to be autonomous in planning their cost and revenue budgets, regulating membership fees, and contracting out management and maintenance services to any type of provider. HOAs are also allowed to hold some units in a condominium in common property and sell or lease them out in order to derive an income (Article 29).

Of particular importance is the provision about eligibility of condominiums to receive “grants, money reimbursements and subsidies” (Article 19). The HA Law guarantees the right of condominium homeowners and tenants to enjoy the social protection provided by effective state and local programs of social safety. Specifically, this social protection implies “the transfer of state and municipal subsidies to HOAs in order to help them finance their operating, maintenance and capital repair costs, purchase some types of communal services and compensate losses from providing discounted services to eligible population groups”. In other words, in event of a creation of a HOA and it being allowed to manage a building, this HOA will be considered eligible to receive all types of grants, subsidies and benefits that are envisaged by current laws and regulations. However, the Law fails to regulate who, in particular, should be a recipient of this financial aid – an association, a management company or a provider of maintenance or utility services – leaving these decisions at the discretion of the authorities that provide this assistance.

When reviewing the provisions of the HA Law ensuring social protection to condominium homeowners and tenants it is also worthy to note that these guarantees were later supported by RF Government resolutions (#707 from 07/18/1996, and #887 from 08/02/1999) regulating rent and housing allowance payment procedures.

Creation of HOAs in new construction.

One of the chapters of the HA Law specifically regulates the creation of HOAs in new construction. This chapter was created in response to the need of many Russian municipalities to find a management model for buildings constructed at the expense of private investors and sold to private owners. Typically cities are reluctant to take on buildings in which they have no ownership of the management. As a result, such buildings are frequently left “to the mercy of fate”, meaning their occupants are left without housing and utility services, and the buildings themselves begin to rapidly lose their value right after the commissioning of them.

The HA Law suggests solving this problem by permitting the registration of a HOA as a legal entity both after and prior to the commissioning of a building and registration of a condominium, as long as it is during the stage of construction (Chapter 6, Article 48). So, the Law makes it possible for investors to register a HOA in advance and thus ensure the immediate transfer of it after the completion of construction to the HOA for management. The Law also makes the registration procedure for such HOAs, easier by only requiring developers to submit an application, a building permit and a draft charter of the HOA (Article 48).

3.4.2 Consistency of the practice of HOA formation with the federal housing policy

Present-day Russia has no more than 5,000 registered associations of homeowners, or just a bit more than 1 percent of the total urban housing stock. This is clear evidence of the failure of the ten years of housing sector reform to accomplish the task of the overall transfer of multifamily houses with lands under them to owners of residential and non-residential units, for the purposes of property management using the mechanisms suggested by the HA Law.

Table 23. Number of homeowners' associations in several Russian cities in January, 2001 (according to local administrations' data)

№№ п.п.	City	Number of HA
1.	Moscow	384
2.	Rostov-on-Don	261
3.	Krasnoyarsk	121
4.	Tiumen	115
5.	Nizhnii Novgorod	110
6.	Perm	100
7.	Yaroslavl	96
8.	Ryazan	87
9.	Novocherkassk	83
10.	Velikii Novgorod	60
11.	Cheboksary	48
12.	Orenburg	40
13.	Vladimir	31
14.	Dimitrovgrad	21
15.	Saratov	6

What is the reason for such poor progress in the formation of condominium associations? The HA Law suggested an instrument for achieving a consensus between homeowners, but it does not work. Perhaps, to some extent it is the fault of lawmakers who failed to remove an array of inconsistencies in the Law revealed in the process of its enactment. There are also discrepancies between this Law and other legal acts; the solution of many vague issues is postponed to the future. The need to improve the Law became clear several years ago, but neither the State Duma, nor the federal government demonstrates their willingness to respond to this need despite the manifold requests of the Gosstroy of Russia and regional and municipal governments.

At the same time it would be reasonable to note that the creation of a favorable environment for the development of condominium associations is mostly the responsibility of regional and local governments rather than the federal authorities. In fact, real incentives – first of all, economic ones – capable to boost the formation of HOAs are created very slowly in comparison to administrative barriers, which grow much faster. Another serious obstacle for encouraging the self-administration of homeowners is the inertness of the bulk of population, which prefers to protect individual interests, doubts that joined efforts may produce better results, and mistrusts (frequently quite reasonably) state and local authorities as well as their housing policy. Manifold recent publications in the press reflect the general suspicious, and sometimes even critical, attitude of the public to the idea of the formation of homeowners associations. The public is more inclined to believe that it is just one more attempt by governmental authorities to shift the burden of housing management and maintenance onto them rather than a chance to use the capacities of self-administration as a solution to the common problems of the housing stock management. Regretfully, very often such suspicions turn out to be true, and adverse experience serves as a major disincentive for the creation of new condominium associations.

Only a few regions in Russia fulfill the requirement of the HA Law to include land under buildings into a common property of condominiums. At the moment, just a very small number of HOAs have an opportunity to manage a totality of condominium property including land. In many cases, the refusal to follow the Law requirement to transfer land to condominium homeowners free of charge becomes a major obstacle for registration of a HOA because registration authorities refuse to register condominiums if they do not have an ownership in the land.

Another serious disincentive for the creation of associations of homeowners is the advisable rather than obligatory nature of the HA Law requirement to provide budgetary subsidizing of housing and communal services to condominiums. In addition, housing allowances and reimbursement of HOA's losses from discounted servicing of eligible households – are not always paid in full and promptly, and, as a result, cause a gap in the HOA revenue budget. In 2000, the Gosstroy conducted a survey among non-profits in various regions of Russia in order to investigate the most common difficulties HOAs face in their operations. The problems mostly frequently mentioned by respondents were non-fulfillment by local authorities of their obligations to finance HOA losses from social benefits and pay housing allowances and subsidies that condominium homeowners are eligible for. As well, they cited the prevalence of administrative barriers and the general lack of knowledge demonstrated by the public.

Noteworthy also is the fact that, as a result of non-fulfillment of the HA Law, difficulties are met not only in the creation of HOAs but in the introduction of other models of property management as well. Notwithstanding the great number of “customer services” across Russia, they very rarely use the management model according to which homeowners are expected to delegate the management responsibility to them under the procedure specified in the HA Law. Typically, residential buildings in Russian cities are managed by agencies appointed by local governments rather than homeowners which, under the Law, should themselves delegate the property management responsibility, in accordance with the model property management chosen by them at their general meeting (Article 22).

Local governments, as owners of municipal property and holders of a large share of ownership in residential buildings, simply undertake to act on behalf of all owners of common property in condominiums without having any legal right to do that, which, in fact, is strongly reminiscent of the property management practices of the Soviet-era housing authorities. The lack of detailed regulations on how to manage residential property when a HOA is not yet created and the strong financial reliance of housing agencies on the municipal budget made it possible for municipalities to control the management of most of the housing stock in urban localities. In the majority of Russian cities, local administrations keep private producers away from the market for housing and communal services and continue inventing mechanisms allowing them to dispose of retail rent and utility fees as they will. This also substantially discourages the process of formation of HOAs because homeowners do not believe that they will be able to get free from the municipality's control to enjoy the freedom in disposal of their resources and selection of providers of property management and maintenance services.

The formation of HOAs requires huge administrative efforts in order to overcome the public indifference and opposition of local bureaucrats and monopolists. Therefore, the progress in restructuring the residential property management sector can be traced only in those cities where homeowners have strong incentives to come through administrative barriers in order to establish real control over the property management in line with the current state policy of the housing sector reform.

As a rule, the progress in formation of condominiums and registration of HOAs is particularly noticeable in regions and cities where local governments are in the lead of the housing sector reform (Moscow, Saint-Petersburg, Barnaul, Tyumen, Yaroslavl, Nizhny Novgorod, Kirov, Samara, Rostov-on-Don, Perm and several others).

It was witnessed that the formation of homeowners' associations on the basis of municipal and housing cooperatives came to a halt in most cities. One exception was Rostov-on-Don, where the city authorities' obligations to carry out capital repairs of the housing stock were a significant factor behind the establishment of homeowners' associations on the basis of municipal housing. Rostov-on-Don's example is worth following. There are other examples of a different kind, too. For instance, in Saratov and Orenburg large homeowners' associations, which include one or even several neighborhood units under the jurisdiction of one municipal housing-maintenance enterprise, are established on the basis of municipal housing stock. When such a homeowners' association is established, the housing maintenance enterprise is liquidated, while its employees become the partnership's employees. In Orenburg, the establishment of such homeowners' associations is initiated by municipal housing-maintenance enterprises because that makes it possible for them to get into private hands without losing their sector of operations and technical base and getting involved in competition with the housing-maintenance service market. At the same time, they acquire tax incentives that are provided to non-commercial enterprises. In Saratov, the establishment of such homeowners' associations was initiated by the local authorities, whose major objective was tax minimization and, in particular, profit tax avoidance. It must be pointed out that such initiatives are spreading to other municipal formations in Russia as they understand that such a noteworthy experience should be followed. This can hardly be denied.

Undoubtedly, housing maintenance on the neighborhood unit scale is much more effective than maintenance of a single house, while private maintenance enterprises are much more effective than municipal ones. However, the interests of residents, who are housing owners, were hardly taken into account during the establishment of such homeowners' associations in Saratov and Orenburg. The partnership establishment decisions were made by municipal governments, who had the largest share in the condominium. In some cases, there were even serious violations of legislation (no general meetings were held, fake tenant signatures were used).

Day-to-day activities of large homeowners' associations also encounters problems in Orenburg and Saratov. The main problem is the reconciliation of interests of a large number of owners. The interests of people living in one particular house may be different from the interests of those living in a neighboring house, which may give rise to conflicts in the partnership. An earlier survey of these partnerships has shown that executive personnel are also elected representatives of the owners and have all the powers of such representatives. As a result, the residents' interest become subordinate to interests of the homeowners' association as an enterprise.

Such examples are rare, though, as private initiative is becoming more visible in the process of the homeowners' association establishment. This is a positive process. What is important, however, is that it must go on within the legal framework.

Condominiums and HOAs are mostly created in large cities on the initiative of developers representing the private business sector, which use HOAs as an instrument for promoting their products on the market. Currently, according to approximate evaluations, more than 70 percent of registered associations of homeowners have been created in newly constructed buildings.

The registration of associations of homeowners in new construction is beneficial, first of all, for developers themselves. It would be safe to state that most developers do appreciate this benefit, because over the last few years the growth in the number of HOAs was mostly caused by rapid registration of associations in new construction. However, many municipalities are also contributing much to the process, as they are usually reluctant to bind themselves with the responsibility to manage and maintain a property that will be sold to private owners. They prefer to shift this responsibility to developers in return for promises to help the latter with the registration of a HOA. Accordingly, in most cases the registration of HOAs in new construction is the result of an agreement between developers and a city rather than the deliberate will of investors and the consequence of developers' "work" with clients. With all apartments sold and

all warranted obligations fulfilled, the developer will most likely go away, leaving occupants of the property with a registered association of homeowners that will have to operate in a rather disadvantageous economic environment (See above).

So, the provision of terms and conditions at least equal to those provided to municipal property management companies is considered to be a task of prime importance the implementation of which will ensure success in HOA operations, help to make the idea of self-administration more attractive for homeowners and give an impetus for the growth of HOAs.

3.4.3. Hypotheses

As is evident from current practices, the rate at which the cities register homeowners' associations and make them responsible for the management of residential property depends on the homeowner's motivation to create an association and the availability of necessary economic and administrative incentives.

Findings of the legislative analysis and statistics showing the number of registered HOAs in various Russian cities as well as the progress in their operations and types of support provided to them by local administrations serve as the basis for making a series of hypotheses about factors which are capable of encouraging or discourage the creation of homeowners' associations in Russia.

Hypothesis 1. *In the initial stages, the key factor in HOA formation in Russia was the demonstration by top governmental officials of their political will to allow private owners themselves to manage their property, which was then addressed in the Law, On Associations of Homeowners.*

In the Russian Federation, by 1996, privatized housing units made up 39 percent of the total housing subject to privatization.²⁷ Nevertheless, a certain number of homeowners still remained unable to manage their privately owned multifamily housing stock themselves. The low efficiency of municipal property management, unreasonable maintenance and repair costs and the lack of direct homeowners' control over spending of resources and quality of services caused a deterioration of living conditions and a fall in quality of life standards. So, the need of a mechanism to transfer the property management responsibility to private homeowners has become evident.

The HA Law suggested principles for the formation of condominiums and registration of associations of homeowners and confirmed their right to hold common property of condominiums in shared ownership as well as their right to manage this property. The enactment of this law was a serious step forward towards liberalization of the housing sector, and therefore it was enthusiastically welcomed by most active representations of the public community and municipalities as a key to success. Within a year and a half after its enactment in many Russian cities associations of homeowners were created in full compliance with this law.

But soon it became evident that the law merely legalized the idea of homeowners' self administration in the housing sector and suggested a juridical form for such self-administration, leaving the provision of necessary incentives capable of encouraging the creation and expansion of condominium associations at the discretion of local governments. It failed to provide any advantages and benefits to HOAs as compared to municipal management agencies as well as to oblige local governments to support HOAs by transferring assets and funds to them. When, at last, many understood that the law failed to provide the best favorable treatment for HOAs and that the management of condominium property required much time, skills and effort, the public enthusiasm gave place to skepticism. As a result, over the last few years the rate of HOAs

²⁷ Annual Statistical Handbook. Goscomstat of Russia, 1996.

creation has subsided in contrast to the period between 1996-1997, and it has become evident that not all HOAs are able to manage their common property effectively.

Hypothesis 2. *The support provided to HOAs by local governments is a major factor advantageously affecting the growth of HOAs.*

Initially, local governments demonstrated a rather great variety of approaches to associations of homeowners. There were cities (Petrozavodsk, Vladivostok) that treated HOAs as a universal remedy for the vast array of housing sector problems. Such cities even quite seriously studied the feasibility of a quick, in a year or two, substitution of all current housing agencies for HOAs and the subsequent termination of the sector subsidizing from the municipal budget. The approach of other cities was quite the opposite. These cities remained indifferent to the idea of registration of HOAs on their territory. If there was still a group of enthusiasts willing to insist on the registration of an association, the city did register it and then stopped thinking about it. This approach is still very popular in many Russian cities.

However, there were cities where local administrations were very active in reforming the housing sector, and (in particular). stipulation of formation of HOAs. In fact, the local governments' approach to HOAs was the main factor affecting the start-up terms of their operation. In Russia, HOAs were created mostly in those cities that were ready to provide both financial and technical assistance to them.

Many cities started their HOA support programs with the opening of a special division in the local administration authorized to work with HOAs. These divisions were obliged to draft regulatory documents governing the provision of assistance to HOAs and their relations with local administrations. As well, the helped HOAs in drafting their by-laws and rules and registration, to estimate the size and methods of subsidizing HOAs, to control the appropriate use of subsidies by them, and also provided consultations and organized training for HOA chiefs and board members.

The creation of financial incentives for HOAs was one of the most important tasks the HOA divisions of local administrations were supposed to deal with. For example, in Ryazan the city decision to subsidize HOAs' maintenance and repair costs taken in 1994 played the key role in the rapid growth of associations in the city. As a result, housing cooperatives that had been earlier deprived of such subsidizing, from this moment on were financially stimulated to re-register as a HOA, and many of them did that. In Perm, the city decision to subsidize capital repair costs of condominium associations became a decisive factor for the growth of HOAs. In Novocherkassk, the authorization to immediately receive a cash reimbursement for losses from the delivery of discounted services to eligible condominium members served as the principal factor for encouraging the homeowners' motivation to register an association. Of particular importance is also the question of whether such subsidies and compensations are paid directly to a HOA account or not. If yes, then homeowners would receive a good opportunity to autonomously dispose of their funds, contract out or do the work themselves as well as exert influence on utility service providers in case of undersupply. However, our investigation has proved that many municipalities fall far short of providing such subsidies to HOAs. Actually, the consent or reluctance of local governments to subsidize HOAs may serve as an important indicator showing the city's motivation to support the development of self-management trends in the housing sector and, in particular, the formation of HOAs.

Some of the sample municipalities have the practice of reducing of a registration fees for HOAs and providing other incentives and preferences on local taxes and charges including land tax, local police tax, education tax, and sometimes even pollution fees. Other cities practice such types of HOA support as the reimbursement of land survey costs to HOAs when they register their land rights, or the transfer of municipal shares in condominium properties to those HOAs responsible for their management.

As is evident from the investigation, all aforementioned types of HOA support – every one specifically and all of them in total – serve as a major impetus for HOA formation, because they create better opportunities for homeowners to manage their common property more or less efficiently. However, such incentives are not provided everywhere and at every time. Often they are used as a temporary instrument and may be easily cancelled by a city in case of a lack of budgetary resources or a lack of interest in the HOAs problems.

Hypothesis 3. *HOA partnerships and HGO support centers may contribute to the encouragement of HOA formation*

When HOAs were first created they were patronized by local governments. On the one hand, this was rather encouraging for HOAs, but on the other, it substantially limited their autonomy and initiative. However, with time, local governments became less interested in providing active support to HOAs. The lack of consulting or any other types of assistance, particularly, in the removal of financial difficulties and in establishing relations with utilities, as well as in the risk to be left without any external support, has pushed many active homeowners and enthusiasts away from the idea, of creating an association. In such circumstances, the role of community organizations and NGOs specifically established to represent and protect the interests of HOAs, housing cooperatives, and TOSs, appears to be of particular importance. Now, many Russian cities are witnessing a quick rise in the number of new organizations ready to provide assistance in registering new HOAs, conducting public awareness campaigns among homeowners, organizing seminars and workshops for condominium property managers, providing financial and legal advice to HOAs, protecting their interests in court and negotiations with third parties.

In the cities that do have partnerships and associations of HOAs, housing cooperatives, unit owners and tenants (Tyumen, Novgorod, Moscow, Cheboksary) as well as NGO support centers assisting the former in management of their property (Novgorod, Rostov-on-Don, Yaroslavl, Perm), HOAs have demonstrated better performance results and may serve as a good example of the realization of the citizens' right to manage their own residential property.

Hypothesis 4. *High rate of new construction in Russian cities encourages the growth in the number of registered HOAs.*

As we have already mentioned above, currently in Russia condominium associations are mostly created in newly constructed buildings (See Table 24).

Table 24. Grouping of HOAs according to types of housing, in which they were created

City	HOAs formed in a specific type of housing, % ²⁸ :			
	municipal %	cooperative %	enterprise %	New construction %
Rostov-on-Don	71	3	22	4
Cheboksary	0	69	0	31
Orenburg	22	33	5	40
Ryazan	6	34	2	58

²⁸ This is a ratio showing the relationship between the number of HOAs formed in a specific type of housing and the total number of HOAs registered in the city.

Veliky Novgorod	1	29	0	70
Dimitrovgrad	3	10	3	84
Perm	0	20	0	80
Moscow	4	10	0	86

Almost everywhere new residential construction is financed by private investors and sold by apartments to private owners. Local governments typically (with rare exceptions) refuse to become the owner and manager of newly constructed residential buildings. If a municipal management company still agrees to become the manager of a newly constructed building, it does it only on the condition that homeowners will register an association so that the company can conclude a contract with it.

So, it appears reasonable to assume that in cities where new housing is constructed at high rate, the number of newly formed HOAs is also growing faster.

3.4.4. Data collection and processing

The suggested hypotheses about factors influencing the rate of HOA formation were subject to testing based on the statistics of 18 Russian cities concerning the number of HOAs registered then, and on data collected by the project team in these cities from their investigation of the HOAs' performance and of local administrations' support of HOAs. For conducting a comparative analysis for the purposes of testing the hypotheses, only data within this sample frame was used. Data from federal sources was not used for the purposes of this analysis, because neither Goscomstat, nor Gosstroy of Russia carries out centralized monitoring of HOA formation and the growth of HOAs' role as a property manager. Up to 2000, the number of registered HOAs was reflected in the standard forms of state statistics²⁹. These forms were filled out by statistic committees on RF subjects which then file them to the federal statistics committee (Goscomstat of Russia). In 2000 this indicator was removed from the standard forms of state statistics, and in 2001 it was also removed from departmental forms of statistics. From time to time, the Gosstroy requests subfederal governments to provide data on the number of HOAs and types of support rendered to them, but this data flow appears to be rather spontaneous and inconsistent, and thus can hardly serve as a reliable source of information.

However, even the available statistics gives rise to doubts. Now and then standard forms of the Goscomstat are filled out by unqualified specialists, and the Goscomstat is not authorized to check the authenticity of collected data.³⁰ Frequently, the statistical forms show the number of HOAs including both HOAs and housing cooperatives, which means that provided indicators are apparently overestimated.

²⁹ Form 22-ZhKH (reform)

³⁰ For example, according to the Goscomstat, in 1999 Dagestan Republic had more HOAs than any other region in Russia (267), although there was registered none of them in the Republican capital, Mahachkala. But it is commonly known that in Dagestan as well as in any other republic in the Caucasus individual one-family houses is the main type of residential property; the stock of multifamily buildings (where condominium associations may arise) is rather small and is concentrated mostly in urban areas, in Mahachkala, first of all. So, it is clear that the presented data was untrue. This conclusion was confirmed by the Republican Ministry for Construction and Housing in its reply to the Gosstroy request made in 2000.

However, in cities that have a special division or at least an officer responsible for maintaining relations with community associations and NGOs working in the housing sector (for example, Orenburg and Yaroslavl) HOAs statistics are collected and processed regularly, and thus appear to be much more trustworthy.

The data used in this survey was received from those municipal formations in which, according to the information available to the authors, the establishment of homeowners' association has been going on most rapidly during the last few years. In such formations, either the number of homeowners' associations grew rapidly or measures to support them were implemented or both. We requested the following information.

Specifically, the cities were requested to provide the following data:

- quantitative indicators (number of registered associations of homeowners, total area of property managed by HOAs, housing construction rates – by years from 1993 to 2001 with HOAs grouped by types of the housing stock, in which they were created);
- qualitative indicators (formation of a special division in a local administration for the work with HOAs; types of support provided by the local administration to HOAs: subsidies, reimbursement of losses from discounted services; transfer of municipal subsidies directly to an HOA account; granting of tax incentives and reduction of registration fees; compensation of land registration costs, organization of training etc.)

It is essential to note that the importance of a city program for developing condominium associations can be assessed most accurately by analyzing data that shows what share of the housing stock in a city is managed by HOAs. There are various ways to measure this share (these measurements will produce different values): HOA as a percentage of the total number of multifamily buildings in a city; the total area of housing managed by HOAs as a percentage of the total area of the housing stock of a city; the size of the city population living in buildings managed by HOAs as a percentage of the total population of a city.

Considering the unfeasibility of obtaining all necessary data for determining these indicators and analyzing changes in them over a long time period, the suggested hypotheses were made on the basis of an analysis of the impact of different factors on the rate of HOA development.

3.4.5 Research findings

Chart 5 shows the HOA creation dynamics in the sample cities.

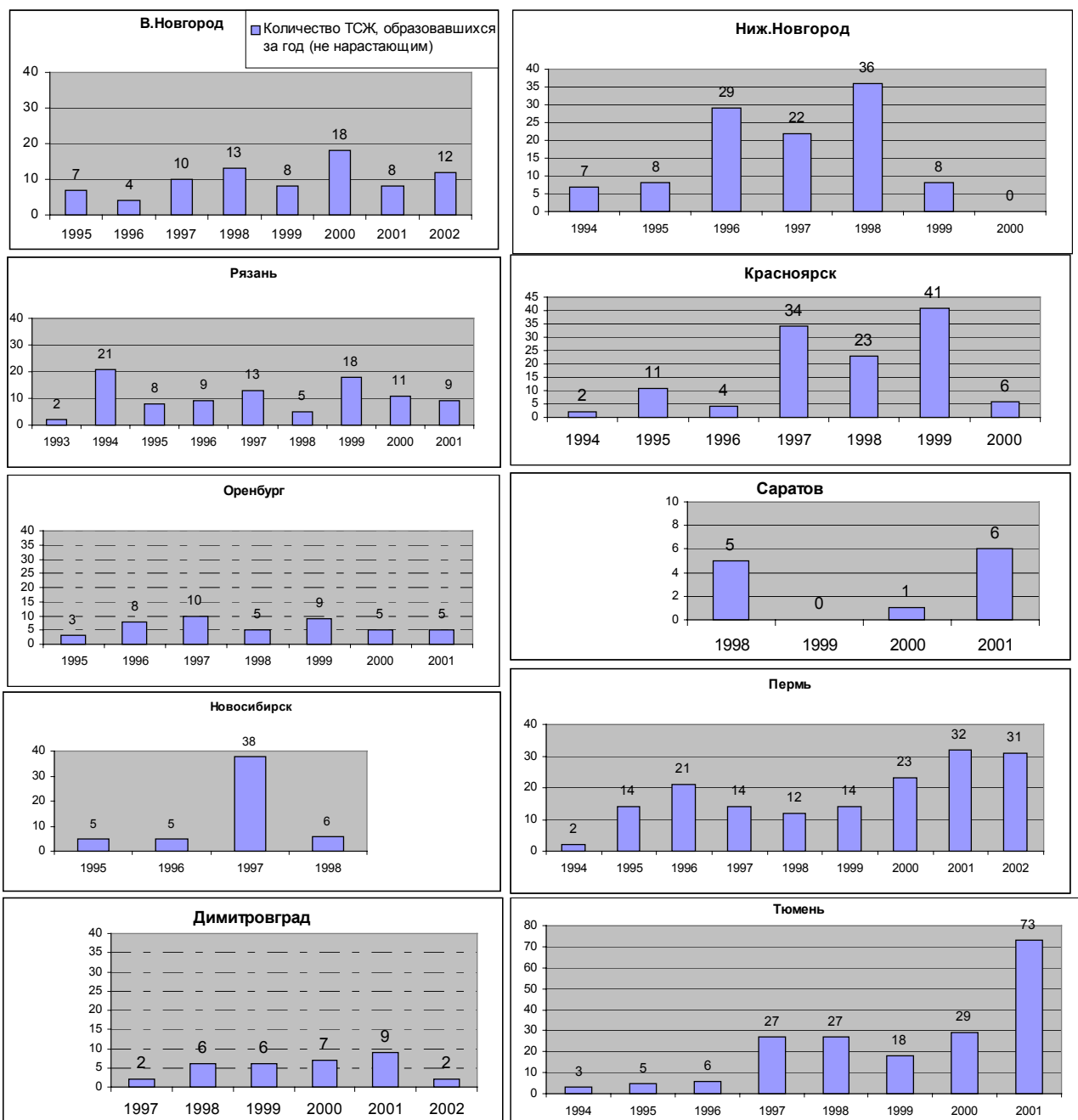


Chart 5

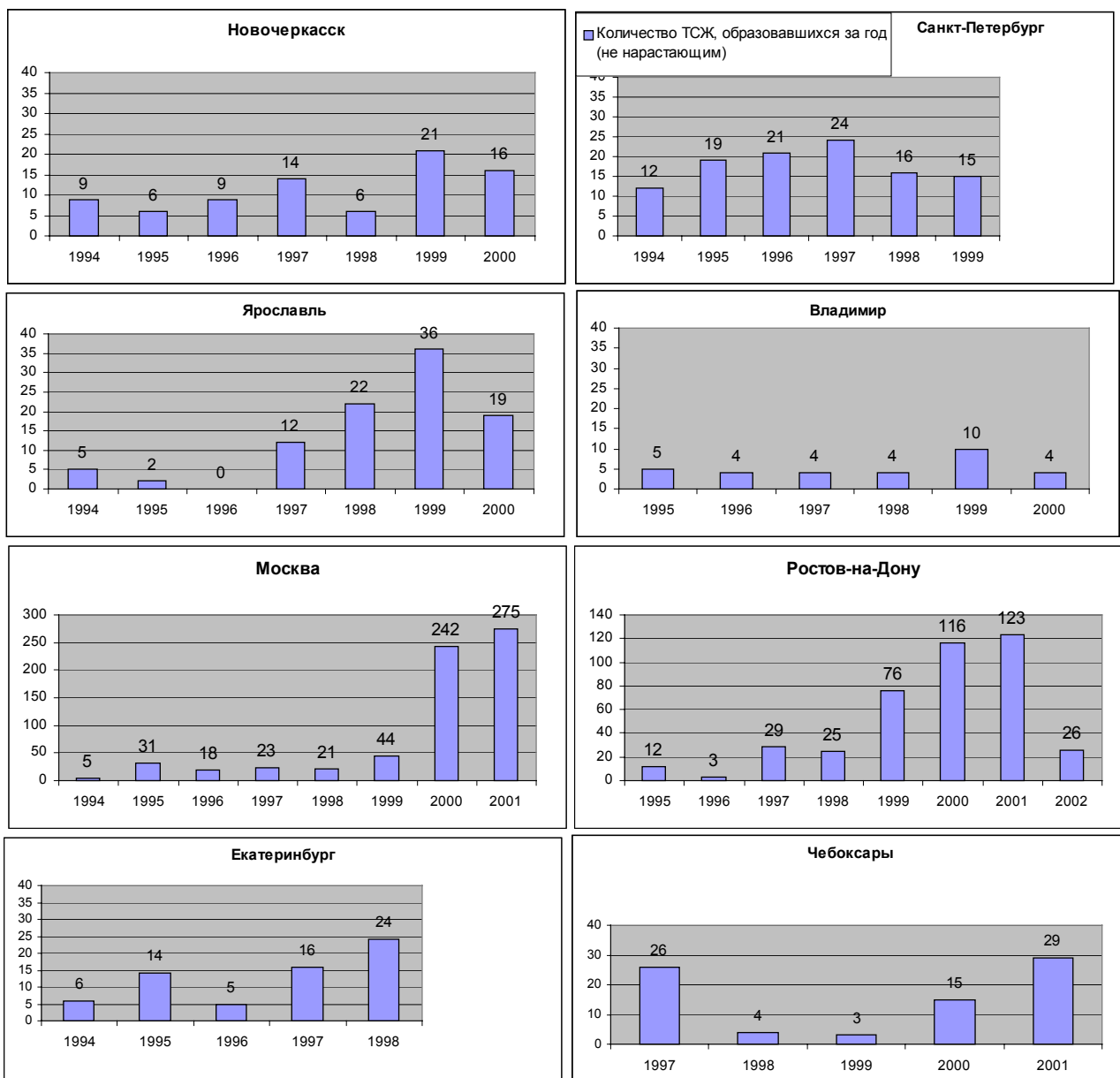


Chart 5. (continuation)

Although the sample is not large, the dispersion of data showing the number of HOAs in the cities is rather significant: from 12 in Saratov to 659 in Moscow (as of the end of 2001). Annually, the number of HOAs grew in average by 20, but, as is evident from Chart 1, this growth was rather irregular, with sudden changes. According to the chart, the sharp growth in the number of HOAs was registered in 1996 – 1997 versus the previous year. This fact stands in favor of our hypothesis that the HA Law enacted in mid 1996 gave a strong impetus to the creation of condominium associations in many Russian cities.

The validity of this hypothesis is also confirmed by findings of the regression analysis of the available statistical data. Bearing in mind the suggested hypotheses, we determined independent variables that, in our opinion, affect the number of HOAs most of all. The regression equation was formulated for one dependent variable (the annual growth of HOAs in each city) and four independent variables specified in Table 11, below.

In the regression analysis, the index showing the HA Law factor has a value of 1 in 1997: the Law was issued in June 1996, and then for a year and a half it was “coming into force” in various regions, meaning its impact was particularly strong in 1997.

A complex index showing the local government support of the HOA formation was estimated separately for every city and year. Its value was determined with the help of the following indicators:

- Formation of a special division in the local administration to work with HOAs (NGOs operating in the housing sector);
- Municipal subsidizing of HOAs to cover price differences in maintenance, repair and heating services;
- Municipal subsidizing of capital repair costs of HOAs
- Municipal subsidizing of gaps in HOAs revenues caused by the necessity to service eligible households at a reduced price;
- Transfer of municipal subsidies directly to a HOA account;
- Compensation of land registration costs of HOAs;
- Reduction of registration fees for HOAs;
- Granting of tax incentives to HOAs (on local taxes only);
- Transfer of ownership of non-residential premises in condominiums to HOAs;
- Organization of training in HOA formation and condominium property management.

Each indicator was assigned a value of 1 if the city did provide the indicated type of support in the indicated year, and 0 if this type of support was not provided. Then, the total of these indicators was determined for each city and each year, which accordingly might vary from 0 to 10. From Table 2 we see that the average complex index is 4.6, which signifies that during the surveyed period local governments in the sample cities provided, on average, 4 -5 types of assistance to HOAs. The highest index of HOA support, 7, was demonstrated by Perm and Rostov-on-Don in 1997 – 2001. Value 0 of the complex index was registered only in two cities – Veliky Novgorod and Orenburg, and only in 1995. That is, prior to the enactment of the HA Law.

For indicating the HOA partnership factor, a simple qualitative variable was used. If there was such partnership in the city the indicator had a value of 1, otherwise it had a value of 0. For indicating the new construction factor, a simple quantitative variable, the volume of new housing commissioned, was used.

Table 24.

Indicator standing for a variable	Variable	Average value
ACG	Dependent variable – annual growth of the total number of HOAs	20.1368
CL	The HA Law factor – the rapid growth of the number of HOAs in 1997 after the enactment of the law. Value (1) in 1997, and (0) in other years	0.1453
PAP	Local government support of HOA formation - a complex index showing how the formation of HOAs was backed up by the city in every year of the surveyed period. May vary from 0	4.6068

	to 10.	
AC	The HOA partnerships factor: value (1) if there is a partnership in the city, and (0) if there is none of them	0.5214
NCI	Annual growth of new residential construction (RF subject's total), mln sq. m	0.7388

Results of the regression analysis are shown in Table 25.

Table 25. Regression Results

Variable	Regression Coefficient
ACG (const.)	-26.203 (-3.272)
CL – the HA Law factor	18.167 (2.343)
PAP - support of HA by the administration	3.997 (2.471)
AC – associations of homeowners' associations'	13.952 (2.495)
NCI - new construction	24.383 (6.185)
(Absolute t-statistics values are shown in parentheses)	
R ²	0.4
F-statistics	18.633
Darbin-Watson statistics	0.815
df (degrees of freedom)	116
Significance level: 5% ³¹	

From the resultant regression equation it is evident that the regression coefficient for all variables is positive and rather high, showing that all variables have a significant value. All the variables have no value of more than 2. This means that all the indicated factors significantly affect the dependent variable in 95% cases of the sample. Therefore, the regression analysis supports all the hypotheses stated above.

The fact that quantitative variables have positive regression coefficients signifies that the number of HOAs grows faster with the provision of every new type of assistance as well as with the growth of new housing construction. The introduction of a new support measure results in the establishment of four new homeowners' associations, while the construction of a million square meters of new housing increases the number of partnerships by 24, which, with the average number of partnerships amounting to 20, amounts to a growth of more than 100%. Calculations of the partnership number elasticity in respect to quantitative variables (change in the dependent

variable in respect to a change in the independent variable by one measurement unit) show that these factors have a significant impact on the dependent variable: in both cases, elasticity tends to one.

The high value of the regression coefficients of qualitative variables also demonstrates the high rate at which the average value of this variable grows when the factor is in effect. One may see that merely the enactment of the HA Law might, on average, result in the registration of still 18 HOAs more in any city in the sample, while the establishment of a partnership of HOAs in a city might increase the number of HOAs by 14 a year.

Thus, the regression allows us to make the following conclusion: support of homeowners' associations by the city administration or a non-commercial organization (an association of homeowners' associations) shows that the city takes a positive attitude toward the self-administration of housing owners and promotes the establishment of new homeowners' associations.

Table 26. Comparison of Cities Taking "Positive" and "Negative" Attitudes to Homeowners' associations

City:	Establishment of homeowners' associations supported by administration -- composite index (variable value)	Role of associations of homeowners' associations (variable value)	Growth of number of housing owners partnerships according to regression results
In case of "positive attitude"	7	1	42
In case of "non-positive attitude"	2	0	8

The hypothesis about the importance of local government support of HOAs was also tested by conducting a survey among municipal administrators responsible for the housing sector management. The survey was conducted in 8 cities³². Respondents had to answer 5 questions about the process of formation of HOAs in their cities formulated in line with the research goals and the stated hypotheses. The survey was anonymous.

The overwhelming majority of respondents (87 percent) believe that condominium associations are a very promising form of residential property management, because HOAs can in practice ensure the compliance of the quality of housing and communal services with the homeowners' needs. At the same time only 60 percent of respondents confirmed that they observed progress in formation and operation of HOAs in their cities.

When asked about obstacles hampering the HOA development, one third of respondents spoke about the lack of financial resources, while two groups of respondents, each comprising 20 percent of the total, spoke about the poor physical condition of condominium property and the lack of homeowner's confidence in the local administration. Still three more groups of respondents, each comprising 10 percent of the total spoke about the deficiencies of the law, the high cost and intricacy of registration procedures, and the lack of qualified property managers.

³² Including: Velikii Novgorod, Cheboksary, Rostov-on-Don, Perm, Ryazan, Moscow, Dimitrovgrad и Nizhnii Novgorod.

At the same time, 80 percent agreed that homeowners themselves would hardly be able to manage property better than the professional staff.

All respondents were unanimous in their opinion that local governments should provide assistance to HOAs, with 80 percent of them considering financial support to be the main factor in the successful operation of HOAs. Among other types of assistance mentioned by respondents there were: procedural and technical guides, training of professional managers of condominium property, development of the market for housing and communal services including services on emergency repair, maintenance of elevators, meters, etc.

Thus, the survey results have confirmed that local administrators in Russian cities understand the importance of the local government support of HOA, but, in general, fail to do it adequately.

3.4.6. Conclusions

1. A real start to the massive formation of HOAs in Russia was given by the HS Law enacted in 1996. During the year and a half after its enactment several Russian cities witnessed a rapid growth in the number of registered HOAs. However, time has passed and it has become evident that the Law has failed to address many problems. The most crucial ones, the economic ones, the solution of which is important for the successful operation of HOAs and are, in fact, assigned to local governments. As a consequence, in municipalities where local administrations had no political will to support HOAs, the formation of them either has subsided or occasionally just stopped.
2. In many cities, local governments are the initiators of HOAs formation. As a rule, they start with launching a broad public awareness campaign, developing the necessary regulatory framework, creating favorable conditions for HOAs (direct transfer of municipal subsidies to HOAs' accounts, granting of tax incentives, free transfer of land plots and non-residential premises in ownership of condominium associations) and organizing training seminars for HOA leaders. In such an environment the number of HOAs grows quickly.
3. Over the last few years local governments have demonstrated a loss and even a full cessation of interest in HOAs. At present, private developers and property managers have taken an initiative in their creation. Thus, it is possible to say that today HOAs are no more the concern of the local government, but that of private businesses operating in the construction and property management market, for whom HOAs act as an efficient instrument in regulating the demand for housing and services of a new type.
4. Local associations and partnerships of HOAs have begun to play a more active role in organization of consultations and training for HOAs, as well as the representation and protection of their interests. In increasing frequency they have started providing services for condominium property management, thus drawing municipal providers of property management and maintenance services into competition. Establishment and active work of HOA partnerships gives confidence to current and future leaders of condominium associations that they might receive necessary assistance and services when needed, and in such a manner also encourage the formation of HOA in Russian cities.

3.4.7. Prospects for and Tasks of the Development of Homeowners' associations in Russia

Our surveys have shown that the reforms in the housing sector which are currently implemented in Russia, such as privatization of housing and reforms in the housing and utilities sector, fail to help prompt activities or arouse the interest of owners of residential and non-residential housing.

At the same time, many former Soviet republics and East European states (transitional economies) whose housing sectors were also in government hands for a long period of time, have made significant progress in the promotion of private enterprise in the housing and utilities sector. For instance, in Kazakhstan, Estonia, Lithuania, Slovakia, Hungary and the Czech Republic, a significant part of former municipal housing stock is now maintained by housing owners' associations or private companies. It should be also pointed out that many of these countries have passed through a period of "shock therapy" in the housing sector. The abolition of government and municipal subsidies to the housing and utilities sector, large-scale compulsory privatization and other measures made it possible to quickly transfer the housing sector into private hands.

One question arising in connection with this is what should be done in Russia in order to catch up with neighboring countries in the development of self-administration of private owners of housing. Should we aim at universal condominium introduction? Is it reasonable to expect that sooner or later Russia's entire housing stock will be placed in charge of homeowners' associations? This will hardly be possible, but the potential for further growth in the number and role of homeowners' associations is significant.

At present, more than half of Russia's apartment house stock is already privatized, while apartment owners pay for the larger part of utilities costs. This state was reached gradually, in the course of ten-year reforms. It should be admitted that the rejection of shock therapy and of gradual liberalization of prices for utilities could hardly help speed development of private enterprise in the sector or promote apartment owners' initiative. At the same time, the forthcoming transition of the housing and utilities sector to the complete cost recovery basis, along with the completion of free privatization of housing, is likely to boost development of private enterprise in the housing sector. However, a certain part of residential housing stock will remain in municipal government hands and will be used for social purposes.

It should also be noted that the purpose of homeowners' associations, as seen by the Russian government and law-makers, consists not only in the demonopolization of the market for housing maintenance services or in the replacement of municipal ownership by private ownership, but it also includes the demonopolization of utility services. A diversity of owners, along with a diversity of management forms, is more likely to lend stability to the housing sector and make services affordable.

Thus, the gradual development of housing owners' self-administration seems more preferable and reasonable now than the rapid and universal introduction of condominiums. As already pointed out above, it is possible to affect the process through the creation of local incentives and favorable conditions for the establishment of homeowners' associations.

The priority measures that must be implemented in order to support homeowners' associations should include the following:

- obligatory transfer of budgetary funds allotted to homeowners' associations in accordance with the current legislation (subsidies and other appropriations) to the partnerships;
- demonopolization of housing maintenance services and creation of competition in the housing and utilities sector;
- popularization of the homeowners' association establishment experience and distribution of information about positive examples;
- training of administrative personnel for the housing sector and training of homeowners' associations' leaders in the basics of self-administration.

CONCLUSION

The realized model of housing and utility sector reforms has produced certain positive results: household payments for the housing and utility services increased substantially; a new form of non-municipal ownership – homeowners’ associations - appeared in multifamily buildings; and the demonopolization processes started in the maintenance services, with private capital penetrating the market. However, these processes have failed to change the inefficient management systems of the housing and utility sector, or to create strong barriers against the return of non-market management mechanisms. Gradual, partial modifications under the rigid control of state and municipal authorities did not allow for a quick qualitative transformation or sustainable self-development of the sector.

The deepening of the crisis in the housing and utility sector that revealed itself so visibly last winter has posed a fundamental dilemma: whether to tighten administrative control of the sector, to strengthen the “management vertical”, to increase budget investments in the sector as the main source of compensation for the inefficiency of its institutional mechanisms, or to move quickly to create preconditions for real market transformations, as opposed to the imitated ones, as until has been the case until recently.

The first approach would essentially solidify for a long time to come the non-market regulation of the housing and utility sector, whose destructive potential was convincingly demonstrated in the past decade. The absence of real economic entities in the system of service production and sale, which are strongly motivated and interested in the efficiency of their operations, the high politicizing of every reform in the sector that distorts or results in the suspension of long-overdue reforms and the deep subsidizing of sector enterprises, which deflects a substantial portion of the budget funds that are needed for developing budget services and for supporting low-income households, all leave little hope for real growth in the efficiency of the housing and utility sector or for moving funds to those public services which are not be provided without budget support (education, health care, social policy). The only viable alternative is the transition of the sector to market-oriented functioning and development mechanisms.

As of this time the economic and political prospects for the housing and utility sector reforms look much more favorable than before. The reasons are several.

First, after a long period of stagnation the economy started to grow and substantial political stabilization has been achieved. Therefore, increases in tariffs for the housing and utility services to households and the termination of flat subsidies to the service providers raise fewer concerns.

Second, the most painful period of tariff hikes is almost over – the overwhelming majority of the regions have achieved 80 to 90 percent coverage of the service costs by households. If it were not for the likelihood of substantial future increases in the tariffs charged for electricity and gas by the key national monopolies, increases in housing and utility tariff would have gradually ceased to be an issue. However, even with account for this growth, tariffs for the housing and utility services will no longer be increased by several times. In addition, the almost universally introduced housing allowances address the task of protecting a substantial portion of low-income households.

Third, in view of the limited margin of safety of the existing life-supporting systems, there is a real political will at the federal level to achieve radical changes in the situation in the housing and utility sector. For all the demagogy around this process, the development of economic relations has no realistic alternative.

Fourth, the growing interest of the businesses on the one hand, and the activity of the households as service users on the other restrain state and municipal interest in the management of the housing and utility sector. More and more examples of successful solutions to the housing sector problems with the use of a market approach are appearing at the local level. Moreover, this trend is fairly stable.

For these tendencies to strengthen and develop, it will be necessary to introduce adequate policies at the state and municipal levels. This presumes both the priority tasks, which may not be postponed, and the strategic tasks that ensure the sustainability and irreversibility of the reforms.

Important priorities include:

1. *Terminating budget subsidies to housing and utility enterprises.* In our opinion, the discussion of this task should replace the fashionable political topic of 100 percent coverage of service costs. The key to this task lies in the transfer of budget funds for the support of the housing and utility services to the households, as has been done by several regions within the framework of a federal experiment with housing allowances. But this is not enough.

The efficiency of budget expenditures may be improved not only through targeted social assistance to low-income households, but also by replacing budget subsidies to enterprises with budget-funded investment programs for the development and modernization of the housing stock and utilities. The simplest example of such program is capital repairs of the housing stock and utility infrastructure. On the one hand, this approach will put a check on tariff increases and on the other, it will ensure control over the efficient use of budget funds in accordance with their targeted purpose. These efforts should be made soon and on a mass scale.

2. *Reducing the level of benefits and ensuring their financing.* The inefficiency and expensiveness of the current system of benefits in housing and utility payments is obvious. The inability of the budget to finance these benefits essentially means that benefits to eligible persons are paid for by their neighbors, which is particularly well pronounced in condominiums and gives rise to serious social problems.

As long as this task is not addressed, it will be unrealistic to expect the housing and utility complex to achieve financial stabilization or to become attractive to investors.

It should be admitted that the in new version of the law, *On the Fundamentals of the Federal Housing Policy*, this issue was raised but failed to get addressed. Once again benefits became the subject of political bargaining in anticipation of the pending elections of the deputies. The 15 billion rubles allocated in the 2003 Federal Budget will, of course, alleviate the situation with compensations for the benefits, but they cannot solve the problem that is estimated to require another 46 billion rubles in 2004.

The task should be declared a priority for 2004 once the election season at the federal level is over.

3. *Restructuring and liquidating the debts of housing and utility enterprises.* The debts of housing and utility enterprises, which reached over 270 billion rubles by the beginning of 2003, are caused primarily by the non-payment of budget compensations for the benefits and allowances provided by these enterprises, and by the non-payment of utility bills by budget-funded institutions. The second important factor is the lack of balance in the tariff policy, that is, cases when tariffs for utility enterprises are not changed following changes in the tariffs for gas or electricity.

The solution of this problem is associated with such unpopular measures as recognizing debt obligations to housing and utility enterprises at all levels of the budget and including these obligations in the next budgets, and increasing tariffs by way of partial compensation of the accumulated misbalance.

The year of 2003 should be devoted to the analysis and formulation of solutions so that practical work for liquidating the debts can start in early 2004.

4. *Creating an efficient tariff regulation system.* Problem issues associated with tariffs and contracts may be addressed by changes in the regulatory framework. The key tasks in this area are:

- to give municipalities the regulatory authority over tariffs of all natural monopolies on the local market, rather than municipal enterprises only;
- to harmonize the tariff regulation principles and mechanisms at the regional and municipal levels;
- to establish principles for the formation and operation of tariff regulators at the regional and municipal levels ensuring representation of all stakeholders, transparency and openness of the regulator's activities;
- to establish clear tariff regulation procedures taking into account the regulation period, factors necessitating a tariff review, information required by the regulator to establish the tariff rate, and other factors;
- to terminate the practice of counting profit in the tariff rate as a percentage of the service cost, building the profit into the tariff rate with regard to concrete investment goals and based on the monitoring of these goals by the regulator;
- to ensure the possibility of incorporating the special tariff regulation conditions stipulated in contracts with investors into the general tariff regulation process.

However, artificially curbing tariff increases by means of administrative pressure on the tariff regulation process is a policy that has no prospects. Apart from failing to reduce unreasonable costs, this approach is a major obstacle to institutional transformations. Ultimately, delayed increases will have to be implemented, inevitably with additional losses in the efficiency of the communal sector. Economic benefits may be produced only if market participants are strongly interested in improving the efficiency of their operations.

In order to implement the tasks identified, it will be necessary to adopt a federal law on the general principles of tariff regulation. In view of the political demand for this law, it may be adopted by the Duma.

5. Creating the legal environment for government – business relations in the communal sector.

The main reform task in this area is to create real economic relations, abandoning administrative management patterns in favor of entrepreneurial initiatives. This task should be addressed through partner relations between governments and businesses operating in the communal sector, when the public authorities guarantee the reliability and affordability of maintenance and utility services at the same time that private companies ensure higher efficiency and lower resource consumption in the delivery of the services.

The attraction of private businesses to the communal sector will both improve management of the sector and turn it into an attractive investment.

Ownership in the utility sector is a critically important issue for both the governments and investors. The responsibility of local government for life-supporting services in their jurisdictions which is stipulated in the legislation may be realized only if utility infrastructure, first of all, the nets, is in municipal ownership. In this context, a preferable arrangement will be that of a contract of concession between a local government and a private company under which infrastructure facilities are retained in municipal ownership, while management of the facilities and all associated commercial risks are transferred to the private company. However, its efficient implementation depends on the creation of the appropriate concession laws. Pending its enactment, a “prototype” contract may be used, stipulating a long-term lease with investment obligations.

6. Promoting the property management business based on individual attention to residential buildings and rational use of resources. At present it is becoming evident that the relative shortcomings in the self-organization of private owners in multifamily buildings into homeowners' associations were caused by the unavailability of an alternative supply of

maintenance services for their buildings. Under such conditions the newly created associations had either to resort to a “natural economy”, or to apply to the municipal monopolies. At the same time, the recent years saw a fairly broad use of the so-called municipal procurement for maintenance and utility services, according to which heat or water was ordered for the entire municipal stock, rather than for a particular building.

Major improvements in the environment for the development of market-based relations in the housing sector may not be achieved through the forced creation of homeowners associations. Rather, it depends on the formation of a competitive supply of services for management of the housing stock. There is every reason to suppose that a variety of supply would promote a variety of demand for these services, serving as a powerful incentive for the creation of homeowners’ associations.

An important task associated with the promotion of property management business in the housing sector is the formation of economic incentives for resource-saving based on the operating scheme of energy-saving companies. In such a scheme, the income of such companies would depend on the reduction of resource consumption in buildings subject to compliance with quality of living standards.

For this field of business to develop, the methodological framework for contractual relations in the delivery of housing and utility services should be put in place.

The development of market relations in the housing and utility sector is strongly restrained by the legal status of the prevailing number of sector enterprises. Most of them have the status of municipal/state unitary enterprises and hold the municipal property by right of economic jurisdiction.

Our analysis shows that political concerns play a key role in the efficiency of reform efforts in the housing and utility sector. It is just as evident that with the pending elections of deputies to the State Duma and of the President one can hardly expect hard political decisions in the area of housing and utility reforms in the near future. In order to ensure people a comfortable winter, the entire force of the administrative resource will once again be mobilized, attracting even Russian oligarchs to the management of the sector. But later the same oligarchs will help to bring home the idea that there is no alternative to market relations if the task is to create normal living conditions for the people.

At present, the reformers’ task is to prepare the necessary instruments which, with a strong likelihood, will produce radical improvements in the housing and utility sector in 2004 – 2005.